

THE RISING COSTS OF HIGHER EDUCATION AND TAX POLICY

HEARING BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES ONE HUNDRED FOURTEENTH CONGRESS FIRST SESSION

OCTOBER 7, 2015

Serial No. 114-OS08

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PUBLISHING OFFICE

22-150

WASHINGTON : 2017

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

COMMITTEE ON WAYS AND MEANS

PAUL RYAN, Wisconsin, *Chairman*

SAM JOHNSON, Texas	SANDER M. LEVIN, Michigan
KEVIN BRADY, Texas	CHARLES B. RANGEL, New York
DEVIN NUNES, California	JIM MCDERMOTT, Washington
PATRICK J. TIBERI, Ohio	JOHN LEWIS, Georgia
DAVID G. REICHERT, Washington	RICHARD E. NEAL, Massachusetts
CHARLES W. BOUSTANY, JR., Louisiana	XAVIER BECERRA, California
PETER J. ROSKAM, Illinois	LLOYD DOGGETT, Texas
TOM PRICE, Georgia	MIKE THOMPSON, California
VERN BUCHANAN, Florida	JOHN B. LARSON, Connecticut
ADRIAN SMITH, Nebraska	EARL BLUMENAUER, Oregon
LYNN JENKINS, Kansas	RON KIND, Wisconsin
ERIK PAULSEN, Minnesota	BILL PASCRELL, JR., New Jersey
KENNY MARCHANT, Texas	JOSEPH CROWLEY, New York
DIANE BLACK, Tennessee	DANNY DAVIS, Illinois
TOM REED, New York	LINDA SANCHEZ, California
TODD YOUNG, Indiana	
MIKE KELLY, Pennsylvania	
JIM RENACCI, Ohio	
PAT MEEHAN, Pennsylvania	
KRISTI NOEM, South Dakota	
GEORGE HOLDING, North Carolina	
JASON SMITH, Missouri	
ROBERT J. DOLD, Illinois	

JOYCE MYER, *Staff Director*

JANICE MAYS, *Minority Chief Counsel and Staff Director*

SUBCOMMITTEE ON OVERSIGHT

PETER J. ROSKAM, Illinois, *Chairman*

MIKE KELLY, Pennsylvania	JOHN LEWIS, Georgia
PAT MEEHAN, Pennsylvania	JOSEPH CROWLEY, New York
GEORGE HOLDING, North Carolina	CHARLES B. RANGEL, New York
JASON SMITH, Missouri	LLOYD DOGGETT, Texas
KRISTI NOEM, South Dakota	
JIM RENACCI, Ohio	

CONTENTS

	Page
Advisory of October 7, 2015 announcing the hearing	2
WITNESSES	
Brian Galle, Professor of Law, Georgetown University Law Center	21
Terry W. Hartle, Senior Vice President, American Council on Education	44
David Lucca, Ph.D., Research Officer, Federal Reserve Bank of New York	5
MaryFrances McCourt, Senior Vice President and Chief Financial Officer, Indiana University, on behalf of the National Association of College and University Business Officers (NACUBO)	32
Richard K. Vedder, Ph.D., Distinguished Professor of Economics, Ohio Univer- sity, and Director, Center for College Affordability and Productivity	16
EXTENDED TESTIMONY FOR THE RECORD	
Terry W. Hartle	107
Richard K. Vedder	132
SUBMISSIONS FOR THE RECORD	
Business Coalition for Fair Competition, BCFC	142
NEXUS Research & Policy Center	150

THE RISING COSTS OF HIGHER EDUCATION AND TAX POLICY

WEDNESDAY, OCTOBER 7, 2015

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:00 a.m., in Room 1100, Longworth House Office Building, Hon. Peter J. Roskam [Chairman of the Subcommittee] presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
Wednesday, September 30, 2015
No. OS-08

CONTACT: (202) 225-3625

Chairman Roskam Announces Hearing on The Rising Costs of Higher Education and Tax Policy

House Committee on Ways and Means Subcommittee on Oversight Chairman Peter J. Roskam (R-IL), today announced that the Committee on Ways and Means Subcommittee on Oversight will hold a hearing on the rising costs of higher education and tax policy. **The hearing will take place on Wednesday, October 7, 2015, in Room 1100 of the Longworth House Office Building, beginning at 10:00 a.m.**

Oral testimony at the hearing will be from the invited witnesses only. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "Hearings." Select the hearing for which you would like to make a submission, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the on-line instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Wednesday, October 7, 2015**. For questions, or if you encounter technical problems, please call (202) 225-3625 or (202) 225-2610.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

3. Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TDD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available online at <http://www.waysandmeans.house.gov/>.

Chairman ROSKAM. The Subcommittee will come to order.

Welcome to the Ways and Means Oversight Subcommittee hearing on "The Rising Costs of Higher Education and Tax Policy."

Right now college students are preparing for a great tradition in this country, homecoming. However, as they head to the tailgates and the football teams are taking the field, parents and some students themselves are facing a harsh reality.

The first tuition checks of the year are clearing the bank, and families are figuring out how to make ends meet, during one of the biggest financial challenges in modern life, that is, figuring out how to pay for the cost of college.

Let us talk about some numbers. The current median income in the United States is about \$55,000 a year. If you look at private, nonprofit, 4-year schools, the average sticker price, meaning the advertised price before financial assistance, is more than \$31,000. For a public 4-year college, it is just under \$10,000, and on top of that, students obviously need to buy food and books and pay rent. The College Board estimates that students spend between \$15,000 and \$23,000 each year to cover those costs.

So without financial aid, college would cost somewhere between \$24,000 and \$54,000 a year, and students are graduating with, on average, \$33,000 a year in student loan debt.

I have a chart I would like to put up.

We talk a lot about the increasing cost of health care in this Committee. Tuition makes those numbers look tame. Medical costs have increased over 600 percent over the last 40 years, but tuition and fees have doubled that, increasing over 1,200 percent and show no signs of slowing down.

So just marinate in that for a second. We have had a huge national debate about healthcare costs, very different opinions, and so forth, but what brought all Americans together was the notion of the acceleration of healthcare costs that was outpacing inflation to a breathtaking point, and yet tuition and fees have doubled the pace of health care.

Today we are here to look at what is behind the rising cost of college tuition and to consider whether this Nation's tax policies are partly to blame.

We will come at the problem from a number of different angles. First, we are going to look at Federal student aid. In 1987, Secretary of Education Bill Bennett argued in a "*New York Times*" editorial that increases in financial aid allow colleges to raise their tuition rates because schools think the students can afford it.

The New York Federal Reserve recently published a study that bears this out. The Federal Reserve study finds that at private schools a \$1 increase in the subsidized loan cap could increase tuition by as much as 65 cents. To be clear about what this means, the data shows that when the Federal Government makes more loan money available, schools generally respond by raising tuition, and one of the studies' authors, economist David Lucca is here today to discuss those findings.

Next, we're going to consider how schools are spending their money. Over the last 30 years schools have significantly increased their administrative staff and engaged in an "arms race" with each other to build things like movie theaters and luxury gyms. Are these expenses necessary? Are they really helping students secure a better education?

We will also look at how private schools are setting their executive compensation rates. For nonprofit institutions, it seems like a lot of university presidents are making very good money. For example, in 2013, 42 private college presidents made more than a million dollars.

One way schools can justify their compensation as reasonable to the IRS for the purpose of favorable tax consideration is to show that similarly situated institutions pay comparable salaries to their executives. Well, that method points in one direction: up. It allows executives to increase their compensation year after year simply because others are doing it, too.

I am not against people succeeding, but this is another area that is important for our Subcommittee to consider. Are the highest paid college and university presidents the ones providing the best education for students? If not, why not? Further, how does tax policy fit into that math?

Finally, we will look at endowments. Currently, endowments and their investment earnings are tax exempt. Congress provides that exemption to further a charitable purpose: better educating our Nation's students, preparing them for successful careers, and increasing the store of human knowledge through research.

We understand that endowments can help assure financial stability to schools, but about 90 schools have endowments of more than a billion dollars, and some of those schools have made great strides in providing exceptional financial aid to their students, but others have not. So we will look at those issues as well.

We look forward to hearing from our witnesses who can shed light on these important challenges as we examine whether Federal tax policies for colleges and universities are best serving students and families.

At this time, I recognize Mr. Lewis for the purpose of his opening statement.

Mr. LEWIS. Good morning. Mr. Chairman, I want to thank you for holding today's hearing on "The Rising Costs of Higher Education and Tax Policy."

I am proud to have many outstanding colleges and universities in my congressional district. Spellman, Morehouse, Georgia State, Clark Atlanta University, Georgia Tech, Agnes Scott, and Emory, all just a few of more than 80 institutions of higher learning in Metro Atlanta.

These and other colleges and universities across the country play a critical role in our society. They educate our young people and create the skilled workforce that we need to compete with other countries around the world.

These institutions train future doctors, nurses, teachers, engineers, and scientists. They build the technology and develop the business leaders that will create a better tomorrow for generations yet unborn. At academic research centers, students and professors seek solutions to the most difficult issues facing the global family. They lead the way in searching for cures to cancer, Alzheimer's, HIV-AIDS and other diseases.

Perhaps most important, institutions of higher learning play a key role in expanding opportunity and reducing income inequality for those who have been left out and left behind for too long. A college degree creates a significant advantage for an individual's lifetime earnings.

For example, in 2014, the average weekly earnings of a college graduate was over 60 percent higher than a worker with only a high school diploma. Every year higher education becomes more important to our Nation's economic needs. Federal student aid programs like Pell Grants and student loans are critical tools to ensure that a college education is affordable and accessible to all who aspire.

In light of a decrease in State support for higher education, it is more important than ever for the Federal Government to do our part and play our role. As Members of Congress, we have a mission, an obligation, and a mandate to keep the dream of higher education within the reach of every student.

I look forward to hearing from today's witnesses and thank you all for being here today.

Thank you, again, Mr. Chairman, for holding this hearing.

Chairman ROSKAM. Thank you, Mr. Lewis.

Today we have a panel comprised of academics, industry experts, college and university representatives, and our panel is as follows:

Dr. David Lucca, Research Officer at the Federal Reserve Bank of New York;

Dr. Richard Vedder, Distinguished Professor of Economics at Ohio University and Director of the Center for College Affordability and Productivity;

Dr. Brian Galle, Professor of Law at Georgetown University Law Center;

MaryFrances McCourt, Senior Vice President and Chief Financial Officer at Indiana University, on behalf of the National Association of College and University Business Officers; and

Terry Hartle, Senior Vice President of the American Council on Education.

Thank you all for your time today.

Mr. Lucca, you are recognized for 5 minutes.

**STATEMENT OF DAVID LUCCA, PH.D., RESEARCH OFFICER,
FEDERAL RESERVE BANK OF NEW YORK**

Mr. LUCCA. Chairman Roskam, Ranking Member Lewis, and Members of the Subcommittee, thank you for inviting me to testify today.

My name is David Lucca. I am a Research Officer at the Federal Reserve Bank of New York. I was born in Switzerland and am happy to share with you that I am a naturalized U.S. citizen as of today.

In July I coauthored, along with Taylor Nadauld of Brigham Young University and Karen Shen of Harvard University, a report entitled “Credit Supply and the Rising College Tuition Evidenced from the Expansion in Federal Student Aid Programs.”

My testimony today, which does not represent the official view of the Federal Reserve Bank of New York or any other parts of the Federal Reserve System, will focus on the research and conclusions in that report.

First I would like to discuss the motivation for our research. The rapid growth in student debt in recent years is reminiscent of the expansion in mortgage credit in the first half of the 2000s, and understanding its consequences is a key economic research question.

Federal aid programs are a key source of student credit with about 90 percent of all student loans in the United States originating under such programs. There are clear economic rationales for government support of student loan programs, but the implications of large credit expansions can be more subtle.

Access to more borrowing increases the spending capacity of each borrower, which generally will boost demand. Our study aims to determine to what degree this increase in demand for higher education may in the short run be reflected in higher tuition prices at postsecondary education institutions.

To that end we studied tuition setting following changes to the annual student aid limits that took place in recent years. Here is a summary of our conclusions.

Our main finding is that changes in subsidized loan amounts have been associated with sizable increases in posted tuition. Our estimate suggests that an additional dollar of per-student credit led to about a 70-cent increase in posted tuition. We find smaller effects on tuition for additional Pell Grants and unsubsidized loans of about 55 cents and 30 cents on the dollar, respectively.

Because of the many factors that went into account for our study, I am much more confident that the subsidized student loan availability has had an impact on tuition as opposed to other forms of aid like Pell Grants and unsubsidized loans.

Our study sample includes a large number of public, for-profit, private and not-for-profit institutions. We find it likely that tuition will rise in response to the greater availability of student loans, to be more pronounced among the more expensive private institutions offering 4-year degrees that are also among the more but not the most selective in terms of admission rates.

We are currently revising the study to expand the sample of institutions and to address helpful comments and suggestions we have received, including some from a trade group represented on today’s panel.

Even with these revisions, we believe our findings on the effects of the availability of Federal student aid on tuition will not materially change. Nonetheless, it is important that our findings not be misinterpreted or blown out of proportion.

I will now discuss some of the limits to our study findings, as well as other factors that you should bear in mind when considering the results of our research.

Our results are not a comprehensive explanation of tuition over longer periods of time and are not informative about other possibly important factors in the rise of college tuition. These other factors could include the decline in State contribution to public universities and an increasing demand for higher education because, for example, of the rising wage gap between college educated workers and others.

Next, the study speaks to posted tuition rather than tuition that the institution discounts and grants because comprehensive measures of these are generally unavailable to researchers. I do not believe that studying the actual tuition paid by students rather than posted tuition will have materially changed our findings, but it would have certainly been preferable.

Finally, while our study suggests that tuition price increases may be lowering the impact of some Federal student aid, these are not the only factors that should be considered when evaluating the effectiveness of student aid. For one, these programs could be essential for students of lower-income families to access higher education.

Also, long-term price effects may be smaller than what we estimate in the short run, as the institutions boost student enrollment capacity over time. This expansion in enrollment may constitute a public benefit as more students could access higher education in the long run.

Thank you for your attention. I am happy to answer any questions you may have.

[The prepared statement of Mr. Lucca follows:]

October 7, 2015

Testimony of David Lucca, Ph.D.

Before the Subcommittee on Oversight

Committee on Ways and Means

U.S. House of Representatives

Chairman Roskam, Ranking Member Lewis and Members of the Subcommittee, thank you for inviting me to testify today. My name is David Lucca. I am a Research Officer at the Federal Reserve Bank of New York. In July, I co-authored, along with Taylor Nadauld of Brigham Young University and Karen Shen of Harvard University, a report entitled “Credit Supply and the Rise in College Tuition: Evidence from the Expansion in Federal Student Aid Programs.” My testimony today, which does not represent the official view of the Federal Reserve Bank of New York or any other part of the Federal Reserve System, will focus on the research and conclusions in that report.¹

Motivation for Our Research

My co-authors and I are not specialists in the field of economics of education, but rather, we are financial economists interested in understanding the role of credit in pricing. This is a longstanding topic in economic research that has recently attracted much attention in the context of the U.S. housing market. Researchers have attempted to establish whether the housing boom-bust cycle of the past decade could be explained by fluctuations in the availability of credit experienced in those years.

¹ The report is available at: http://newyorkfed.org/research/staff_reports/sr733.pdf. I have also appended to this testimony a detailed description of our research methods.

The rapid growth in student debt in recent years is reminiscent of the expansion in mortgage credit in the first decade of the 2000s. Despite the reduction in overall household debt in the aftermath of the Great Recession, according to data from the New York Fed, student debt outstanding has kept its pre-crisis upward trajectory, and at \$1.2 trillion, it is now the largest form of non-mortgage debt for households. These trends have, not surprisingly, captured much public attention. Understanding their implications is also a key research question because of the macroeconomic consequences.

Federal aid programs are a key source of student credit, with about 90 percent of all student loans in the U.S. originated under such programs. A standard economic rationale for governmental student loan programs is that education is a human capital investment. This investment can be hard to finance because human capital is an intangible good, which cannot be used as collateral by borrowers to promise to repay loans to private lenders. The government can circumvent these problems by either lending to students without additional guarantees or by other means, such as making loans non-dischargeable in bankruptcy or subject to wage garnishments. Most economists would agree that from the point of view of a single borrower, such lending programs can be beneficial.

But with a large group of borrowers, the effects of additional credit can be much more subtle. Access to more borrowing increases the spending capacity of each borrower, which generally boosts demand. This increase in demand for higher education will be partially reflected in higher tuition prices and margins at post-secondary education institutions, unless student enrollment capacity is promptly expanded and institutions compete away the rationing of college placements that give rise to tuition increases.

Obstacles to expanding enrollment capacity exist, either because entry of new institutions may take time, or because it may be hard for existing institutions to expand their teaching faculty and facilities. As a result, one should expect an increase in student credit to lead to a rise in tuition, at least in the short run. While economic theory suggests the likely existence of a price effect, it is silent on the actual magnitude. Our study is an attempt to find this evidence and provide such a measurement.

It is well known that the cost of post-secondary education has risen very sharply over the past years. After adjusting for inflation, average posted (or, as it is also referred to, sticker or published) tuition rose 46 percent between 2001 and 2012, increasing from \$6,950 to \$10,200, or about 3.2 percent per year.² But the contemporaneous increase in college tuition and availability of student loans is not, in itself, evidence of a causal effect of student credit on tuition. Other factors, such as a reduction in non-tuition sources of revenues, or an increase in the demand for higher education, could be boosting tuition cost and resulting in additional student borrowing—rather than the other way around.

Summary of Our Study

Our study aims at establishing a causal link from the expansion in student credit to tuition. It focuses on program changes to the subsidized and unsubsidized federal loan programs available to undergraduate students under Title IV of the Higher Education Act. The federal government pays interest on a subsidized student loan when a student is in school, while students are always responsible for interest payments in unsubsidized loans.

² Posted prices are more readily available to researchers, but universities engage in extensive price discounting based on merit and need. Data on effective prices charged by institutions display somewhat more muted trends, but even these prices have significantly outpaced the rate of inflation over the same years. For a review see, for example, Congressional Research Service Report R43692 (2014) entitled “The Relationship between Federal Student Aid and Increases in College Prices.”

Subsidized loans are offered depending on financial need. In addition, we also consider Pell Grants because they experienced program changes that partially overlapped with those on the loan programs. Pell Grants are also awarded to students in financial need, and unlike loans they do not need to be repaid.

We study tuition-setting between the 2007-08 and 2010-11 school years when per-student annual federal aid limits were increased.³ These aid limits determine the maximum amounts that a qualifying student can receive. We compare tuition-setting behavior of institutions as a function of the number of students receiving aid at the annual limits ahead of these policy changes. Institutions with a larger fraction of students borrowing at federal aid program limits were more affected by changes in federal aid policies, as compared to institutions that had fewer students receiving aid at these limits.

Our main empirical finding is that changes in subsidized loan amounts have been associated with sizable increases in posted tuition. Our estimates suggest that an additional dollar of per-student credit led to a 70-cent increase in posted tuition. We find smaller effects on tuition for additional Pell Grants and unsubsidized loans of about 55 cents and 30 cents on the dollar, respectively. Overall, these results are consistent with the so-called Bennett Hypothesis, according to which an increase in student aid can result in a higher cost of education.

One possible concern with our approach is that institutions where students are most dependent on aid may differ in many dimensions from institutions where students

³ The combined maximum subsidized-unsubsidized federal loan amount for freshmen rose in the 2007-08 academic year from \$2,625 to \$3,500, and for sophomores from \$3,500 to \$4,500; additional unsubsidized loan maximums rose by \$2,000 in the academic year 2008-09. Prior to those changes, federal loan limits had been unchanged since 1993. Pell Grant annual maximums rose gradually from \$4050 in the 2006-7 year to \$5,550 in the 2010-2011 school year. Our sample ends in 2012 and additional changes to annual aid limits, which are not considered in our study, have taken place since.

do not depend as heavily on aid. These other characteristics, rather than student exposure to federal aid, could coincidentally drive the differential tuition increases that we observe in the years of the changes in federal aid. In the study we attempt to account for a number of these characteristics such as state support, admission rates and program types. As a result of this analysis, it is hard to conclude whether Pell Grants and unsubsidized loan availability affect tuition at all. In other words, I am much more confident that subsidized student loans have an impact on tuition, as opposed to other forms of student aid like Pell Grants and unsubsidized loans.

Our study's sample includes a large number of public, for-profit private, and not-for-profit institutions. We find the likelihood that tuition will rise in response to the greater availability of student loans to be more pronounced among the more expensive private institutions offering 4-year degrees that are also among the more, but not the most, selective in terms of admission rates.

Interpreting the Results

Our research study aims at establishing a causal link between the expansion in student credit availability and tuition between the 2007-08 and 2010-11 school years. Our results suggest that this effect exists, especially for loans made under the federal subsidized loan program. We are currently revising the study to expand the sample of institutions and to address helpful comments and suggestions we have received, including some from a trade group represented on this panel. It is important to note that we do observe some variation in our estimates depending on the exact specification of our statistical model, but the approximate magnitude of the results does not change.

Our results are evidence of a causal link between student loan availability and tuition. They are not a comprehensive explanation of tuition trends over longer periods of time and are not informative about other, possibly more important factors in the rise of college tuition. These other factors could include (1) the decline in state contributions to public universities and (2) an increase in demand for higher education because of the secular rise in the college-wage premium or, more recently, because of the lower opportunity costs of attending college when the unemployment rate rose following the Great Recession.

Our study speaks to posted tuition rather than tuition net of institution discounts and grants, because sufficient, comprehensive measures of these discounts and grants for the years we are studying are unavailable to researchers. But we find that net prices typically move in tandem with posted prices, meaning that posted prices do ultimately matter to students. We also do not find systematic rebates by institutions in terms of grants to students around the policy changes. That said, studying the effects on effective (net) rather than posted tuition would certainly be preferable.

While as researchers we do not observe the tuition-setting process of institutions of higher learning, the availability of federal aid programs clearly matters for pricing at certain institutions. For example, transcripts of public discussions between market analysts and senior management at some publicly traded for-profit private institutions offer anecdotal evidence of the link between federal aid and pricing.⁴ These anecdotes

⁴ See, for example, the following excerpt from 2007:Q2 Earnings Call for the Apollo Education Group as accessed from Bloomberg LP Transcripts: **Operator:** Your next question comes from the line of Jeff Silber with BMO Capital Markets. <**Q - Jeffrey Silber**>: Close, it is Jeff Silber. I had a question about the increase in pricing at Axia; I'm just curious why 10%, why not 5, and why not 15, what kind of market research went into that? And also if you can give us a little bit more color potentially on some of the pricing changes we may see over the next few months in some of the other programs? <**A - Brian Mueller**>: The rationale for the price increase at Axia had to do with Title IV loan limit increases. We raised it to a level

should be taken as such. They show that some institutions directly price with an eye towards federal aid, which is consistent with our statistical findings, but they are not proof of broader tuition-setting practices in the post-secondary education industry.

Finally, while our study suggests that tuition price rises may be lowering the efficacy of some federal student aid, these are not the only factors that should be considered when evaluating the effectiveness of student aid. First, these programs could be essential for students of low-income families to access higher education. Further, long-term price effects may be smaller than what we estimate in the short run, as institutions boost student enrollment capacity over time. This expansion in enrollment might constitute a public benefit, as more students could access higher education in the long run. Indeed, we find evidence in our paper that over long periods of time, school enrollments have increased more at institutions where students are more dependent on student aid.

Thank you for your attention. I am happy to answer any questions you may have.

we thought was acceptable in the short run knowing that we want to leave some room for modest 2 to 3% increases in the next number of years. And so, it definitely was done under the guise of what the student can afford to borrow. In terms of what we will do going forward with regards to national pricing we're keeping that pretty close to the vest. We will implement changes over time and we will kind of alert you to them as we do it.

Appendix: Detailed Description of Our Research Methods

Short of randomized trials, which are typically unavailable to social scientists, economists have often relied on so-called natural experiments to measure causal effects. In a natural experiment, the group of individuals receiving a treatment, the “treated” and the remaining individuals, the “untreated” (or control group) are not randomly assigned and the experiments are not designed by the researchers. Instead, the treatments determination and experiment are observed in “nature,” which in economics often means observed as a result of a change in public policy.

Our study relies on a natural experiment provided by changes in the per-student aid limits in Title IV federal student aid programs. While changes in federal aid policies affect, in principle, all Title IV eligible institutions nationwide, their impact will vary depending on the characteristics of each postsecondary institution’s student body. This is because changes in the program caps only directly affect students that receive aid at the program maximums. The fraction of students at the program caps at each institution depends on an institution’s cost of attendance and the distribution of students’ financial circumstances. We use data from the National Postsecondary Student Aid Study (NPSAS) database, which is provided to researchers by the Department of Education, to sort the sample of all post-secondary education institutions in terms of the fraction of students that are at the cap for each student aid program.

Rather than assigning institutions to a treated or untreated group, all institutions are sorted on a continuous scale of more and less-exposed institutions. We first verify the validity of our sorting measure by comparing changes in per-student aid between the more- and less-exposed institutions. As expected, institutions that have more students exposed to the policy changes experienced significantly larger increases in aid around the policy changes. Having verified that our experiment appropriately identifies institutions whose students received more or less aid in response to policy changes, we then use the component of the aid increase predicted to be the result of the policy changes, and study its effect on posted tuition across institutions and around the policy changes. This comparison is what identifies in the statistical model the effect of more aid on tuition, just as in a randomized trial one would compare the average outcome for the treated and the untreated group.

Chairman ROSKAM. Thank you, Dr. Lucca.
Dr. Vedder.

**STATEMENT OF RICHARD K. VEDDER, PH.D., DISTINGUISHED
PROFESSOR OF ECONOMICS, OHIO UNIVERSITY, AND DI-
RECTOR, CENTER FOR COLLEGE AFFORDABILITY AND
PRODUCTIVITY**

Mr. VEDDER. It is widely agreed that the American tax system violates most of the basic principles of taxation relating to simplicity, efficiency and fairness, and that tax reform should lead to lower marginal rates, an expanded tax base with fewer exemptions, credits, and special loopholes.

Higher education tax policies contribute somewhat to this problem. People can lower their tax liability by making gifts to non-academic aspects of university life, such as building fancy stadium skyboxes or luxurious resort-like housing facilities. Tax treatments of some collegiate compensation arrangements deserve scrutiny.

But today I want to talk mainly about university endowments. Almost a half trillion dollars is invested in university endowment funds. The distribution is extremely unequal. The top 1 percent of measured endowments has nearly 30 percent of all the funds.

There are several schools with over 1 million dollars in funds for every student, enough to provide \$50,000 per student in annual investment income, using a 5 percent payout rate. The average institution, however, has about \$25,000 of endowment per student, while endowments are particularly critical for private institutions. Four of the 15 largest ones are held by State universities.

My student associate Justin Strehle and I have used econometric techniques to examine the relationship between endowment spending and several key variables, looking at a sample of nearly 500 schools, including most of the largest and most prestigious American colleges and universities.

The basic question asked is: Are endowments used for useful public purposes? Let me share four conclusions.

First, endowments are not generally used to lower the stated tuition fees of colleges. There is no statistically significant relationship between endowment size and tuition fees.

There are exceptions. Berea College in Kentucky, the College of the Ozarks in Missouri, and historically Cooper Union in New York City have used endowments to essentially eliminate student fees, but that is rare.

Second, endowments are used some to provide scholarships, effectively lowering the actual or net tuition fee paid by students. However, assuming a 4 or 5 percent payout rate, the evidence suggests that typically less than 20 cents out of every dollar of endowment income goes for this purpose. Making college more affordable is not the dominant use of endowed resources.

Third, because of inherent measurement issues, it is difficult to assess the relationship between endowments and institutional quality.

Fourth, magazines rank schools mainly on how they satisfy student needs. Do students like the professors, excel after graduation, avoid much debt, graduate in a timely manner, and so on?

Controlling for other factors, there is no statistically significant relationship between the quality of an institution and an endowment size.

Fifth, there is some indication that some endowment funds go to increase faculty compensation at institutions. In some cases, this might lead to higher quality teachers and researchers, but it might also lead to excessive bureaucracies or unjustified pay increases rather than meeting student needs. The evidence is somewhat murky but raises real questions about whether endowment funds mainly serve social objectives justifying special tax treatment.

The quality gap between the public and private school has widened over time partly because of Federal student loan policies and increasingly parents believe success depends on their children getting into highly endowed academic, gated communities, such as Ivy League schools. This trend is arguably inconsistent with basic American egalitarian ideals, and special tax preferences of endowments, especially for extremely wealthy schools, may be of questionable social value.

Thank you.

[The prepared statement of Mr. Vedder follows:]

TESTIMONY OF RICHARD K. VEDDER
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
OCTOBER 7, 2015

It is widely agreed that the American federal tax system violates most of the basic principles of taxation relating to simplicity, efficiency, and fairness, and that tax reform should lead to lower marginal rates, and an expanded tax base with fewer exemptions, credits, and special interest loopholes. Higher education tax policies contribute somewhat to this problem. People can lower their tax liability by making gifts to non-academic aspects of university life, such as building fancy stadium sky boxes or luxurious resort-like housing facilities. Tax treatment of some collegiate compensation arrangements deserves scrutiny. But today I want to focus on university endowments.

About one half trillion dollars is invested in university endowment funds. The distribution is extremely unequal –the top one percent of measured endowments has nearly 30 percent of all funds. There are several schools with over one million dollars in funds for every student, enough to provide \$50,000 per student in annual investment *income* using a five percent payout rate. The vast majority of institutions, however, have well under \$100,000 of *endowment* per student. While endowments are particularly critical to private institutions, four of the 15 largest ones are held by state universities.

My student associate Justin Strehle and I have used econometric techniques to examine the relationship between endowment spending and several key variables, looking at a sample of nearly 500 schools, including most of the largest and most prestigious American colleges and universities. The basic question asked is: are endowments used for useful public purposes? Let me share four conclusions:

First, endowments are *not* generally used to lower the stated tuition fees of colleges. There is *no* statistically significant relationship between endowment size and tuition fees. There *are* exceptions – Berea College in Kentucky, the College of the Ozarks in Missouri, and, historically, Cooper Union in New York City have used investments to essentially eliminate student fees. But that is rare.

Second, endowments are used some to provide scholarships, effectively lowering the actual or net tuition fee paid by students. However, assuming a four or five percent payout rate, the evidence suggests typically that less than 20 cents out of every dollar of endowment income goes for this purpose – making college more affordable is not the dominant use of endowed resources.

Third, because of inherent measurement issues, it is difficult to assess the relationship between endowments and institutional quality. *Forbes* Magazine ranks schools mainly on how they satisfy student needs – do students like their professors, excel after graduation, avoid much debt, or graduate in a timely manner? Controlling for other factors, there is *no* statistically significant relationship between the quality of the institution and endowment size.

Fourth, there is some indication that some endowment funds go to increase staff compensation at institutions. In some cases, this might lead to higher quality teachers and researchers, but it might also lead to an excessive bureaucracy, or unjustified pay increases, rather than meeting student needs. The evidence is somewhat murky, but raises real questions about whether endowment funds mainly serve social objectives justifying special tax treatment.

The quality gap between public and private schools has widened over time, partly because of federal student loan policies, and increasingly parents believe success depends on

their children getting into highly endowed academic gated communities such as Ivy League schools. This trend is arguably inconsistent with basic American equalitarian ideals, and special tax preference of endowments, especially for extremely wealthy schools, may be of questionable social value.

Thank you.



Chairman ROSKAM. Thank you, Dr. Vedder.
Mr. Galle.

**STATEMENT OF BRIAN GALLE, PROFESSOR OF LAW,
GEORGETOWN UNIVERSITY LAW CENTER**

Mr. GALLE. Thank you, Mr. Chairman, Ranking Member Lewis, Members of the Subcommittee.

My name is Brian Galle. I am a professor at Georgetown University Law Center.

American colleges and universities are the best in the world, but for reasons that are in part out of their control, and probably Congress', costs in the education sector have risen faster than inflation, a lot faster, and likely will in the future. Costs are rising because of structural factors in the economy and the nature of nonprofit organization. These are things that are hard to change in the short term.

But our tax policy has also, in my view, contributed in a couple of ways to cost growth. Tax policy has encouraged universities to save money instead of spending it on students, and has helped to drive up administrators' salaries.

Let me talk first about endowment funds and then executive compensation.

To be clear, universities should have endowments. They should have a pool of money that is set aside for future needs in case times get tight. But modern universities are taking their rainy-day savings to possibly absurd extremes. You could read Harvard's 2013 tax return. Harvard could put all of its investments in a money market fund tomorrow, make its tuition free for all, and then keep spending at 2013 levels for another 12 years. That is quite a rainy day.

Most colleges and universities have spending policies that are designed to keep the school's endowment growing in real terms after inflation terms forever. According to the National Association of College and University Business Officers, the average private school spends less than 5 percent of its net investment assets every year.

So if you make a gift to your alma mater and you restrict that gift to a particular purpose, most schools have a rule that will prohibit them from spending more than 5 percent of the gift in any year. That way the school is only spending investment earnings and is never spending that gift principal.

This growth plan is working. Education costs have gone up, but college investment assets have grown a little faster, and the bigger each school's investment account grows, the more money they have to pay their fund managers in order to invest.

Now, that is all money that could be going to need-based financial aid. It could be going to outreach to underserved communities, to new teaching technologies, cutting-edge research. It is a lost opportunity, in other words. You can understand why colleges' alumni would like the idea that their alma mater is going to keep getting richer forever, but it is not necessarily a good idea for America. We should be investing in kids' futures, not bond futures.

I do not necessarily get behind the idea of government telling market actors how to run their businesses, but it turns out in this

case we already are. Federal tax policy is contributing to the culture of big college wealth accumulation. We give a bigger tax break to donors who restrict their gifts so that the gifts cannot be spent right now, and the longer it takes to spend the money, the bigger the tax break.

Keep in mind that if the 5 percent spending plan works as colleges intend, the school will never spend the donated principal that the donor took a deduction on when given.

There are a few ways to fix the problem. I am not a fan of taxing endowments or endowment returns because I think taxing investments has unwanted distortive effects on investments and other choices. Also, as I am sure you know, this body in the past has considered extending the minimum payout rule that applies to private foundations, to educational organizations.

I support minimum payouts for private foundations and donor advice funds, and actually think the current level of minimum spending should be higher, but a floor might not be flexible enough admittedly for a charity that, unlike a foundation, has a huge workforce and consumer base. So my recommendation would be to consider reducing or eliminating the tax advantage that comes with giving to organizations that restrict their endowment spending.

We could calculate how long it will take to spend out a gift at current spending levels, compute the extra tax benefit the donor is getting as a result, and reduce the current contributions by some fraction of that amount. Then at least we would just be neutral toward instead of encouraging saving over spending on students.

Let me also now talk about administrator compensation. Without oversight, administrators can make decisions for their school that make it easier for them to be more highly compensated. For instance, my research suggests that schools with more tuition and more endowment savings tend to pay their administrators more.

The existing oversight comes mostly from Section 4942 of the Tax Code, the so-called intermediate sanctions regime. These are the rules that say a school has to pay a penalty for overpaying its top administrators. Under the regulations, schools get the benefit of the doubt if they can show that their compensation is comparable to others, and, of course, no one wants to say that their president is below average, so you get a ratcheting up effect.

My research shows that pay started going up much faster in 2002 after the IRS issued the comparable salary rule. This is an area where my research suggests that it is possible that market forces could work if we gave them a little bit of help.

I find that when you make it easier for donors to know what executives at their alma maters or the other institutions they are supporting are getting paid, they will respond fairly quickly if they think those administrators are getting too much. So instead of asking the IRS to guess what a comparable salary is, we might instead just require a more complete and honest disclosure of presidents' pay packages, including items that right now are usually pretty opaque, like housing, travel in summertime, and benefits.

Thank you again for inviting me to testify today. I am happy to answer any questions you may have.

[The prepared statement of Mr. Galle follows:]

Written Testimony of Brian Galle¹
Before the House Ways and Means Committee Subcommittee on Oversight
Hearing on the Rising Costs of Higher Education and Tax Policy
October 7, 2015

Thank you, Chairman Roskam, and members of the subcommittee, for inviting me to speak today, and for holding this hearing. My testimony focuses on the relationship between federal tax law and (1) the spending and endowment policies of U.S. colleges and universities; (2) the compensation of top college and university administrators; and (3) both of those and the costs of higher education.

Rising Education Costs

By nearly any measure, American colleges and universities are the best in the world. In the past decade or two, however, the costs of obtaining a college degree have grown substantially. In my research I find that net tuition, or tuition minus financial aid, grew by over 30% in real terms over a decade at a sample of selective colleges and universities.²

The rise in the costs faced by students track a growth in the costs universities themselves face. The Higher Education Price Index (“HEPI”) is a measure of inflation for the basket of goods and services usually purchased by colleges and universities. Since the beginning of the millennium, HEPI has grown at about twice the rate of inflation in the overall economy.

Scholars who study education attribute this rapid inflation in large part to a problem known as cost disease. Briefly, cost disease occurs when productivity in some sectors of the economy rises slower than in others. In our modern era, this usually happens when one sector is highly dependent on skilled human inputs that can’t easily be replaced or supplemented with automation. Health care is another major example of an industry that suffers cost disease.

As in health care, relatively weak mechanisms for price competition may also contribute to higher education’s costs. It is difficult for “consumers” of education to directly observe education quality until they have already “consumed” it, and many of education’s biggest benefits inure to those, such as employers and society at large, who do not pay directly for it. Prospective students often don’t learn about

¹ Professor of Law, Georgetown University Law Center.

² Brian Galle & David Walker, *Nonprofit Executive Pay as an Agency Problem: Evidence from U.S. Colleges & Universities*, 94 B.U. L. REV. 1881 (2014). The sample covered 387 colleges and universities over a ten-year period from 1997 to 2007.

financial aid awards until quite late in the school application process. These factors make it difficult for schools to compete on price. Therefore it is not surprising that the “sticker” price for tuition before financial aid falls within a relatively narrow band for almost all private schools.

Relatedly, education costs may in some measure be driven by the preferences of college and university decision makers, rather than the consumers. Universities are mostly controlled by faculty and administrators with little oversight by outsiders, and studies suggest these insiders often prefer to compete on the basis of “prestige” and other measures of quality rather than on cost.

Effect of Endowments and Agency Problems on Student Costs

The cost factors I have described so far are deeply embedded in the nature and institutional arrangements of modern higher education. It is not obvious that government policies can have much short- to medium-term impact on these cost drivers. There may be other contributors, however, that could be more susceptible to influence from policy makers. Some of these more accessible cost-drivers, in fact, are arguably caused by existing, misaligned, government-made incentives.

The first of the misaligned incentives is university endowment policy. An “endowment” is simply a pool of savings that has been set aside, either by donors or the institution, for use in the future.³

Most colleges and universities have spending policies that are designed to keep the school’s endowment growing, in real terms, forever. According to the National Association of College & University Business Officers (“NACUBO”), the average private school spends less than five percent of its net investment assets each year.⁴ If you make a gift to your alma mater, and you restrict that gift to a particular purpose, most schools have a rule that will prohibit themselves from spending more than 5% of the gift in any year. These rules are intended to preserve the real, after-inflation, spending power of the initial gift or set-aside funds. In effect, the school is only spending investment earnings, and is never spending the gift principal.

Further, schools generally refuse to budget expenditures out of expected gifts. That is, even if the university has reason to expect that donations will increase, it

³ Funds that are voluntarily set aside by the institution itself are sometimes referred to as “quasi-endowment” or “temporarily restricted” because in theory the institution could remove its own use restrictions, although this is very rarely done. According to NACUBO, quasi-endowment represents about 45% of endowment balances at private schools, and about 20% of endowment balances at publics.

⁴ The most recent NACUBO study can be found at http://www.nacubo.org/Research/NACUBO-Commonfund_Study_of_Endowments.html.

spends only out of funds that have already been pledged. The result is that new gifts always expand the budget.

Overall, these growth plans appear to be working to create larger and larger endowments. Data from the U.S. Department of Education and NACUBO suggest that university assets and investment assets have grown a bit faster than HEPI on average, and accordingly more than twice as fast as overall inflation.⁵

Obviously, when an institution chooses to set aside some of its present revenues for the future, current students and other beneficiaries lose out. Money reserved for endowment could instead be spent on need-based financial aid, outreach to underserved communities, new teaching technologies, even cutting-edge research.

It is sometimes argued that endowment savings allow for greater long-run expenditures, as the investment earnings, when added up over time, eventually exceed the nominal value of the original gift. As Henry Hansmann, a professor at Yale Law School, has shown, this argument is wrong-headed.⁶ Given that HEPI is rising faster than inflation, endowment savings are simply trading off cheap present purchases for more expensive future consumption. We can think of his point in terms of shopping for a new rug. The schools' policy is like saving up during a rug sale so that we can afford to buy the rug later at full price.

Endowments also do not manage themselves. Data on endowment management costs are not directly collected by any government agency, and so are limited to inference and anecdote. Recent popular press accounts suggest, however, that some schools pay more of their endowment funds to investment managers than they allocate to financial aid. The larger the endowment, the greater these costs become.

The appeal of endowments for university administrators may not just be their supposed power to expand future output. As David Swenson, the famed Yale endowment manager, has written, endowments give administrators relative freedom from dependence on government funders, current donors, and other "outside" influences.⁷

This freedom certainly has some virtues, but it also has costs. In my work with David Walker of Boston University, we find that college and university presidents with greater endowment wealth to draw on, or who are otherwise less

⁵ Authors's calculation, based on the NACUBO-Commonfund 2014 study and the 2000–2010 Delta Public Release data from the National Center on Education Statistics.

⁶ Henry Hansmann, *Why Do Universities Have Endowments?*, 19 J. LEGAL STUDIES 3 (1990).

⁷ David F. Swenson, PIONEERING PORTFOLIO MANAGEMENT 10–14 (revised & updated ed. 2009).

dependent on current donors, are more highly compensated than others.⁸ Prior researchers have made similar findings.⁹ While there can be several possible explanations for these results, one plausible story is that administrators with fewer constraints feel freer to take higher salaries and more perks.

Of greater concern, administrators' desire for the freedom to receive more compensation may drive policies that increase some aspects of education spending. For example, Professor Walker and I also find a correlation between gross and net tuition and president's compensation. Presidents who are under more pressure from donors, we find, also tend to expand enrollment, perhaps as a way of justifying their award packages or of collecting more total tuition dollars.¹⁰

Federal Tax Law Contributes to University Endowment Policies

Federal policies intended to underwrite charitable activity have had the inadvertent effect of encouraging donors and the institutions they support to postpone the expenditure of donated dollars. The federal government and most states allow taxpayers to reduce their taxable income by the amount of any donation to an eligible charity.¹¹ Similarly, decedents' estates can deduct the amount of any money left to charity from the amount subject to federal tax.¹² Donors receive these deductions at the time of the donation, regardless of when the donee charity actually expends the funds (and regardless of any restrictions on sale the donor may impose on the gifted assets). Charitable organizations, including most colleges and universities, are also exempt from the federal corporate income tax. This allows for tax-free growth of endowments.

As Professor Daniel Halperin has shown, this combination of rules strongly incentivizes delayed spending.¹³ By contributing their investment assets to a foundation earlier than they want the funds spent, donors can allow those investments to grow tax-free. In contrast, if they held the investment themselves, they would often have to pay tax on any appreciation. The longer the university,

⁸ Brian Galle & David Walker, *Nonprofit Executive Pay as an Agency Problem: Evidence from U.S. Colleges & Universities*, 94 B.U. L. REV. 1881 (2014).

⁹ E.g., John E. Core et al., *Agency Problems of Excess Endowment Holdings in Not-for-Profit Firms*, 41 J. ACCT. & ECON. 307 (2006).

¹⁰ Brian Galle & David Walker, *Donor Reactions to Salient Disclosures of Nonprofit Executive Pay: A Regression-Discontinuity Approach*, 44 NONPROFIT & VOLUNTARY SECTOR Q. __ (forthcoming 2015).

¹¹ IRC § 170(a).

¹² *Id.* § 2055.

¹³ Daniel Halperin, *Is Income Tax Exemption for Charities a Subsidy?*, 64 TAX L. REV. 283 (2011).

rather than the donor, holds the assets before spending, the larger is this tax subsidy.¹⁴

A less-familiar aspect of the rule allowing full deductibility for restricted gifts is that it facilitates tax planning. Donors can contribute at the moment that the deduction will generate maximum value—usually when their tax rate is highest or the value of the assets they are contributing is at its peak—without having to trade off that goal against their preference for when to fund charitable projects. Similarly, a donor who otherwise intends to fund projects arising after her death can double her tax benefit by making a restricted gift during life, allowing her to reduce both income and estate taxes.

Why Congress Should Reduce Tax Incentives that Increase Endowment at the Expense of Current Education Consumers

Whether or not endowments are a good idea for universities, Congress should reconsider the tax rules I've just described. In general, in a well-functioning market we should expect private actors to make decisions that maximize their own welfare. Current tax law distorts the decisions of educational institutions and their supporters, to no apparent good policy goal.

Certainly there is no obvious argument for why society would prefer that colleges and universities save *more* than those institutions would themselves choose. Most of the institution's constituents have reasons to desire some level of precautionary savings. Students and alumni, for example, know that their alma mater's name will appear on their resume for most of their life. They want some assurance that the school will maintain or increase its quality and reputation over time. And administrators, we saw, may have their own reasons for wanting to build endowment.

Furthermore, gifts that are held perpetually in an endowment are not a cost-effective way to subsidize charity. The tax cost to the government of a perpetually restricted gift, in present-value terms, can be as much as double the cost of an unrestricted gift. Most current estimates of the cost-effectiveness of the charitable

¹⁴ Prof. Halperin acknowledges the counter-argument that other tax rules might allow for effectively the same treatment, but this is an unnecessary concession. Donors who contribute publicly-traded stock to a foundation can deduct the full value of the gift without paying tax on their built-in gains, seemingly achieving the same end result as early contribution. To avoid all tax on her donated assets, though, the donor must never exchange them, from the day she acquires them until the day they are donated. This lock-in is itself economically costly, since it prevents the donor from switching away from under-performing investments. At the margin, we would expect donors to accept a lock-in cost of just a hair short of the full amount of the tax saved. So the ability to contribute built-in gain securities with no tax is less valuable than it appears at first glance.

contribution deduction suggest that the deduction on net delivers more than a dollar of charity for each dollar of government subsidy, but only barely so.¹⁵ Halving the deduction's efficacy would leave it far short of that important policy threshold.

I do not mean to suggest that universities should not have endowments. It is entirely sensible for an organization with a large, relatively fixed budget to maintain a pool of money set aside for future needs, in case times get tight. But modern universities are taking their rainy day savings to absurd extremes. Consider Harvard's 2013 tax return, the most recent available. Harvard reports roughly \$4 billion in annual expenditures against about \$49 billion in investment assets. If Harvard ceased bringing in any revenue of any kind tomorrow—perhaps shifting all its investments to cash, and declaring that all students will attend for free—it could still keep spending at 2013 levels for another *12 years*. And this ignores Harvard's considerable ability to borrow against existing capital assets and future potential revenues. It is, in other words, hard to imagine that endowments of this size can be justified by any realistic "rainy day" scenario.

Endowments are also a means of transferring current wealth, including taxpayer supports, to the future, but it is unclear either why we would want such transfers, or why we would choose endowment savings as a way to make them. Future society is likely to be considerably wealthier than ours is today, increasing money available to donate to higher education, increasing demand for education, and perhaps reducing its marginal returns. If anything, this implies that schools today should be borrowing against future wealth.

Moreover, even if transfers to the future were desirable, we have much better investments available than endowment savings: today's students. Studies suggest that the future social returns on expanding access to higher education can exceed financial returns by a good bit, especially when one accounts for the cost of seeking out and managing those financial returns. Need-based aid and outreach to underserved communities can pay much better than a hedge fund can.

Policies to Increase College & University Spending on Current Needs

Congress has several alternatives for mitigating existing tax incentives for endowment build-up. While there are strengths and weaknesses of each approach, I would recommend emphasizing options that focus on reducing the value of charitable contribution deductions tied to gifts that will be spent out over long periods.

¹⁵ Jon Bakija, *Tax Policy and Philanthropy: A Primer on the Empirical Evidence for the United States and Its Implications*, 80 SOC. RESEARCH 557 (2013).

Under this proposal, a donor's charitable contribution deduction would be reduced by some fraction, perhaps 100%, of the excess tax value created by any time restrictions attached to the gift by the donor or the donee institution. For example, government might calculate how long it will take to spend out a gift at current spending levels, compute the present value of the extra tax benefit (relative to immediate spending) the donor is getting as a result, and multiply this amount by some fraction, such as 50 or 100%. The resulting amount is subtracted from the amount deductible. Because of the relative complexity of this method, it might be applied only to gifts of some size, such as \$10,000 or above, for which the donor can be presumed to have sound legal advice.

To illustrate, suppose that in year one donor A makes a restricted gift of \$1 million to a university Z. University Z has a rule under which only 10% of the value of a restricted gift may be spent in a given fiscal year. Under prevailing rates of return, this gift will take, say, 20 years to spend. Let us assume that the discounted present value of exempting 20 years of investment returns is \$100,000. Donor A would reduce her charitable contribution deduction in year one from \$1 million to \$900,000.

A simpler but otherwise less appealing policy would be to impose a tax on "excess" endowment balances.¹⁶ An "excess" balance can be defined as an amount above the amount needed to sustain current spending for some period in the event of reasonably expectable declines in the institution's revenues. A typical reserve fund of this kind might hold on the order of fifty percent of a full year's expenditures.

Taxes on endowment have several potentially serious economic side-effects. An endowment tax, if imposed without any additional correctives, could actually reduce current spending levels. Managers with a target level of endowment might "pay" the tax out of current expenditures, rather than out of endowment earnings. In addition, an endowment tax may reduce managers' incentives to invest the endowment at the optimal level of risk, and to err instead on the side of excess conservatism.

A third alternative, previously considered by this body in 2007 and 2008, would be to extend to universities the private foundation rules requiring an annual minimum payout of net investment assets. I believe that minimum payouts are an important constraint on private foundations, and indeed that current required payout levels are probably so low that they are allowing the private foundation

¹⁶ Taxes on endowment balances are clearly superior to taxes on endowment returns. See Daniel Halperin, *Tax Policy and Endowments: Is Excessive Accumulation Subsidized? (Part II)*, 67 EXEMPT ORG. TAX REV. 125 (2011). A tax on endowment returns of any significant size will, like any tax on capital, distort the institution's choice of investments and the timing of their purchase and sale.

sector to grow excessively large.¹⁷ Further, minimum payouts should be extended to organizations that largely mimic the purposes and functioning of private foundations, such as the so-called donor advised funds.

However, payouts may not be an ideal fit for operating charities. Again, colleges and universities have large and relatively inflexible annual budget commitments. A private foundation can simply curtail its grant-making activities if its budget drops unexpectedly and there are not adequate reserves; universities cannot easily cut enrollment or payroll. Payout floors arguably might not provide adequate fiscal flexibility in those circumstances, even if calculated on a rolling average of several years rather than the current one-year period.

Payout floors may be a useful complement to an endowment-balance tax, however. To the extent that endowment taxes may tend to depress spending out of endowment, a mandatory payout could reduce the degree to which taxes displace endowment spending.

Tax Policy and Executive Compensation

As I discussed earlier, both government tax policy and university endowment policy are intertwined with pay practices for top administrators. Endowments and tuition payments each may tend to facilitate greater pay awards, and administrators may manage their institution in ways that maximize cash flows that are most likely to allow the administrator to maximize pay. Pay of top college and university executives has grown quite rapidly in the past decade and a half. In the sample of colleges and universities I studied, total compensation rose by an average of about seven percent per year in real dollars over the period 1997 to 2010.

Federal tax law may have contributed to this growth both indirectly, through its effects on endowments, and also more directly as well. In 2001 the IRS finalized regulations interpreting section 4942 of the Internal Revenue Code, the so-called “intermediate sanctions” regime. These are the rules that say a private school can pay a penalty for over-paying its top administrators. Under the regulations, schools get the benefit of the doubt if they can show that the board of trustees examined other presidents’ compensation awards and determined that their own executive’s was “comparable” to the others’. Of course, no one wants to announce to the world that their president is below average, and so there is a tendency for a ratcheting effect. My research with Professor Walker shows pay started going up much faster

¹⁷ Brian Galle, *Pay It Forward? Law and the Problem of Restricted-Spending Philanthropy*, 92 WASH. UNIV. L. REV. __ (forthcoming 2016).

in 2002, after the IRS issued that rule.¹⁸ This may be a coincidence, of course, but the timing is at least rather suggestive.

This is an area where my research suggests the market, with some small assistance, might work as well or better than government oversight. Professor Walker and I find that when we make it easy for donors to know what the president of the institution they support is being paid, they will respond fairly quickly if they think she's getting too much.¹⁹ Instead of asking schools to construct elaborate evidence of "comparable" pay, the law might simply do more to encourage timely and complete disclosure of president's pay packages, including items that currently are usually highly opaque, such as housing, travel, and some retirement benefits. For instance, a revised section 4942 might make such disclosures, rather than reliance on "comparables," the basis for a presumption that the president's pay is reasonable.

Under present law this solution will work only for private universities. The 4942 regulations exempt public universities from the intermediate sanctions regime entirely. The reasons for that exception are unclear, but appear to derive from comments during the rule-making process in which some public universities argued that they would be able to obtain tax-exempt status as an arm of their respective states, rather than under section 501(c)(3). Congress should clarify that, whatever the source of an organization's tax exemption, eligibility for deductible contributions carries with it the obligation to comply with the rules against self-dealing and excessive compensation set out in section 4942.

Conclusion

Thank you again for inviting me to testify today. I hope that my perspective on these issues helps the Committee as it thinks about the difficult problem of higher education expenses.

¹⁸ Brian Galle & David Walker, *Nonprofit Executive Pay as an Agency Problem: Evidence from U.S. Colleges & Universities*, 94 B.U. L. REV. 1881 (2014).

¹⁹ Brian Galle & David Walker, *Donor Reactions to Salient Disclosures of Nonprofit Executive Pay: A Regression-Discontinuity Approach*, 44 NONPROFIT & VOLUNTARY SECTOR Q. __ (forthcoming 2015).

Chairman ROSKAM. Thank you, Mr. Galle.
Ms. McCourt.

**STATEMENT OF MARYFRANCES MCCOURT, SENIOR VICE
PRESIDENT AND CHIEF FINANCIAL OFFICER, INDIANA UNI-
VERSITY, ON BEHALF OF THE NATIONAL ASSOCIATION OF
COLLEGE AND UNIVERSITY BUSINESS OFFICERS (NACUBO)**

Ms. MCCOURT. Thank you for this opportunity.

I am speaking on behalf of the National Association of College and University Business Officers, representing financial officers at 2,100 colleges and universities.

I came to higher education 10 years ago after 20 years as a corporate finance executive. At Indiana University, I managed one of the largest and most complex institutions of higher education in the country, with an annual operating budget of over \$3.3 billion, over 105,000 students across seven campuses.

I take very seriously the responsibility to deliver on the purpose of higher education, to enhance intergenerational mobility, and drive the knowledge creation and innovation that supports economic growth.

As demographic, geographic, financial and cultural forces reshape our economy, we are using sophisticated business analytics tools to implement our mission and optimize our operations to meet the expectations of all of our stakeholders, from parents and students to our donors, to the U.S. economy at large.

I am held accountable by IU's governing board of trustees who hold the university's financial, physical and human assets in trust for today's students and future generations.

The dramatic erosion of State support has been our most challenging financial pressure. In the mid-1980s, State operating appropriations made up 58 percent of the general education fund budget, and tuition and fees just 26 percent. That ratio has now completely flipped. Just since 1990, had State appropriations kept up with CPI, we would have received \$125 million more in our fiscal year 2014 budget, and had it kept up with the higher education price index, we would have received \$225 million more just that year.

However, we have managed to thrive through our focused attention on running efficient operations, to reallocate resources for strategic investment. Historically low tuition increases are our new normal.

Just as an aside, at Indiana University, tuition increased this past fiscal year from zero dollars a week to \$4.46 a week. Despite this, we have invested heavily in student success in affordability with significant attention to the reduction of student debt. Our institutional aid budget of \$287 million has increased \$139 million, or 106 percent, over the past 8 years.

The national focus on sticker price rather than net price is missing this important fact. The majority of students are not paying sticker price, and student debt at Indiana University had decreased over \$82 million, or 16 percent, in the past 3 years.

We also balance short-term needs with long-term financial viability. We have comprehensive long-term financial models to proac-

tively manage our several billion dollar operation commensurate with corporate business practice.

Our strategic financial planning also includes prudent management of our endowment. Endowed funds established contractually with donors represent IU's promise to use income and investment gains generated by their gifts to support a donor directed initiative tied to our mission into perpetuity.

Legally our endowment cannot be used as a rainy day fund. Donors must consent to a change in use. Endowment distributions, be they for financial aid or other operational areas, relieve tuition pressure and have served as a critical contributor to student access.

Private donors are transferring wealth for the public good, and access to higher education has never been greater.

In a recent report Child Care Aware of America found that in 2013, the average annual cost for an infant in center-based care was higher than a year's tuition and fees at a 4-year public college in 31 States and the District of Columbia. Our faculty and staff are highly educated and are often experts or leaders in their field. Our academic programs and operations require state-of-the-art information technology. A standard of care demanded by the employers of our students. The cost of providing infant and childcare simply does not compare to the cost of running our center for applied cyber research, cyber security research, or our national center for genome analysis support.

I raise the comparison to day care because while there is a public outcry that the cost of college is too high, we have not had a fundamental conversation about what a college education should cost to ensure America's educational institutions remain the finest in the world.

Are higher education institutions concerned about student affordability? All day long, yes.

As I examined the issue, I asked myself what has happened since the financial crisis that moved this conversation front and center. The crisis impacted families' ability to pay for college. Median household income has remained flat. Housing wealth and volatile stock markets limited parents' ability to draw on their savings and other forms of borrowing. Families turned to student loans.

We will continue to maintain our focus on these issues and we will continually direct attention to the role we all play in the multitude of factors that are contributing to this national issue as we work to fulfill the dreams we would have for our own children: A bright future built on a strong educational foundation.

Thank you for having me here today.

[The prepared statement of Ms. McCourt follows:]

Statement of
MaryFrances McCourt
Senior Vice President and Chief Financial Officer, Indiana University
on behalf of the
National Association of College and University Business Officers
Before the
U.S. House of Representatives
Committee on Ways and Means
Subcommittee on Oversight
October 7, 2015

Introduction

Thank you for inviting me today to testify at this hearing on the rising costs of higher education and tax policy. My name is MaryFrances McCourt and I am the Senior Vice President and Chief Financial Officer at Indiana University. I came to higher education 10 years ago, after 20 years as a corporate executive, the last 14 of which I spent in the technology industry (during its boom and decline). Today, I am here on behalf of NACUBO, the National Association of College and University Business Officers. NACUBO is a membership organization representing more than 2,100 public and private nonprofit colleges and universities across the country and around the world. Its primary membership is chief business officers.

Since 1974, NACUBO has sponsored, with partners, an annual endowment survey. The NACUBO-Commonfund Study of Endowments (NCSE) is the largest and longest-running survey series of higher education endowments in North America.

The most recent study gathered data from 832 U.S. colleges and universities for the 2014 NACUBO-Commonfund Study of Endowments® (NCSE). The institutions participating in this year's Study withdrew \$21.2 billion from their endowments—providing financial access to education so today's students have the tools to build a strong future *and* supporting the overall research and public missions of their respective institutions.

I am eager to share with you today some background on how institutional leaders work collaboratively to take into consideration the institutional mission, vision, and programmatic needs when crafting college and university budgets. This necessitates an ability to work effectively with enrollment management, invest in student services, provide guidance relative to the endowment, assure that campus facilities are well maintained and meet the needs of educational, research and service programs, and manage debt. It also means facilitating the growth of undergraduate enrollment in degree-granting postsecondary institutions to enable economic growth in the United States and to ensure first generation and minority student enrollment is supported as well. Institutions of higher education are making significant investments in student persistence, completion, advising, career counseling, financial literacy, and other academic services to ensure student success.

The trustees who govern our institutions in furtherance of educational, research, and service missions, at the same time expect us to manage our operations based on sophisticated business principles and hold us accountable to performance metrics that align with corporate gold standards. These trustees are often successful business executives themselves.

Today, I also want to take this opportunity to illustrate the importance of endowments to colleges and universities. This hearing provides a welcome opportunity to make clear the fundamental guidelines that investment managers and boards of trustees must adhere to when managing endowments. These guidelines can be summarized in three words: perpetual, growing, and consistent.

Perpetual. Endowed funds represent an institution's promise to donors to use income and investment gains generated by their gifts to support an aspect of the university's mission into perpetuity. Donors who direct their gifts to endowments expect institutions to strike a balance between supporting current needs and ensuring the funds meet the needs of future generations, meeting the mission and needs of students and the campus community here and now as well as long into the future.

Growing. Investment managers are obligated to manage funds in such a way that financial gifts continue to grow over time—thus enabling withdrawals to keep pace with inflation while supporting other necessary investments in student support, research, etc. This fiduciary responsibility is articulated in a legally-binding agreement between the donor and the institution. These agreements and guidelines for distribution as well as prudent investment standards are also governed by uniform code—set in state law—across the country. Endowment investment policy statements are developed and approved by university foundation boards and investment professionals.

Consistent. As a chief financial officer, I seek low volatility over time in my operating budget to meet the consistent demands of fulfilling our mission as a public research institution. Indiana University relies on the endowment for a steady flow of operating revenue. Fundamentally, endowments are expected to provide stable funding to the university while creating inter-generational equity by balancing the current and future needs of the university. Mandating endowment payouts to fund a “flavor-of-the-month” would simply equate to poor financial management.

Balancing Budget and Tuition Demands

The single most challenging financial constraint we've faced in recent years at Indiana University is the fact that the state has not been able to appropriate adequate funds to keep up with inflation and enrollment growth. Revenue from tuition and fees now makes up more of our budget than state appropriations as a percentage of our operating revenue. The proportion of our budget from state appropriation and from tuition and fees has flipped since the mid-1980s.

However, we have managed to thrive. Historically low tuition increases are the “new normal” at IU. We have invested heavily in student success and affordability, with the reduction of student debt as a key focus. As chief financial officer, I have also been driving the business division to find operational efficiencies, with much success over the past several fiscal years.

But the last several years have been a demanding and uneasy time for us as well as the entire public and nonprofit higher education sector. The economic situation has improved somewhat, but it has not yet stabilized—leading to uncertainty about short- and long-term funding, and how to manage costs. Institutions, like IU, have taken action with a wide array of initiatives, from more internal consolidation to increased external collaboration.

We are past the point of acknowledging the “new normal” and most institutions are dealing with pressures to maintain their infrastructure (both human and physical) and invest in student success and welfare. Many institutions must invest in the research missions that drive U.S. innovation, while at the same time address extreme price sensitivities to tuition and consider student affordability. Indiana University is a notable representative for public higher education as we run a large complex university comprised of eight campuses that range from a large, flagship research institution to smaller regional campuses with significant non-traditional student populations.

Setting Tuition

As a corporate executive, before coming to Indiana University, a key area of focus for me was financial modeling and analysis. This experience has become invaluable in the tuition setting process. Tuition and fee increases emerge only after examining numerous financial models (at IU we typically look at approximately 50 different analyses) built on details that reflect campus-, school-, and unit- level sensitivities. Key inputs on these projections include:

- Enrollment credit hours by school
- Healthcare and other employee benefit costs
- Investment in student initiatives (student welfare, completion, persistence and more)
- Compliance initiatives
- Technology investment

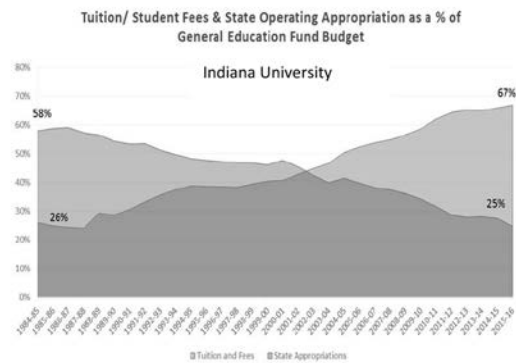
Many of these budget considerations can be projected at a remarkable level of accuracy. The key variables to estimating our operating budget model are tuition and fees and compensation increases. Several models are done to determine the appropriate balance of being able to offer our employees a minimal salary increase—the compensation pool has not increased more than 2 percent since I arrived at IU and we’ve had some years with no increase or a delayed increase— and keeping our tuition increases as low as possible in light of the pressures on students’ ability to pay.

There have been many operational efficiency initiatives to decrease operating expenses and we have made significant strides here. But, this industry is marked by a cost structure based predominantly on labor. And a significant portion of that labor is semi-fixed with tenure-track faculty.

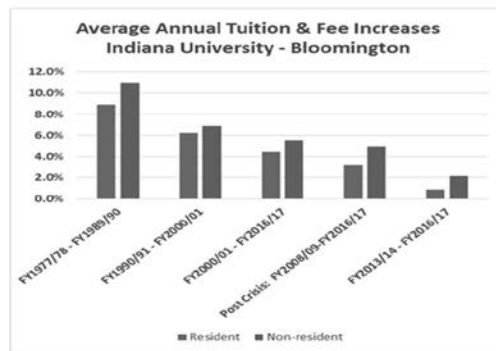
The Role of State Appropriations

At Indiana University, the share of the General Education budget funded by state appropriations versus that of tuition and student fees has reversed since the mid-1980s and the state appropriation per student full-time equivalent (FTE) dramatically declined. This is a trend with state-operating appropriations for public higher education we are seeing across the nation.

As state appropriations decline, institutions of higher education have hard choices. Institutions can raise tuition to preserve quality; decrease spending despite effects on student learning, retention, and graduation rates, and compliance, safety, and other programming; limit admission slots; cut employee benefits; etc. Increasing productivity by increasing class size/ professor throughput at the cost of quality is not an optimal option.



Institutions of higher education in the United States have also been impacted by extensive federal compliance requirements. There has been significant additive investment in compliance related to research, tax (employee, student, private use, Build America Bonds, etc.), data security, student safety (weather, active shooter, student welfare, and other emergency preparedness), revenue processing, etc. Many institutions of higher education have now established dedicated compliance offices.



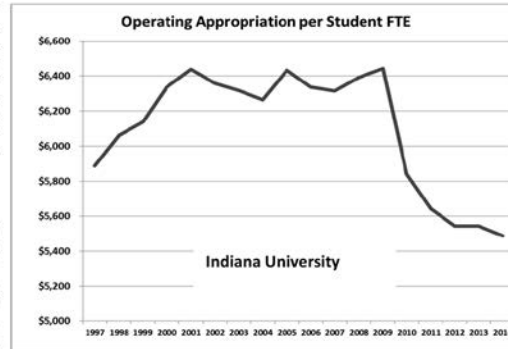
What are we doing to help students?

Undergraduate enrollment in degree-granting postsecondary institutions has grown more than 50 percent since 1990, and the proportions of first generation and minority students are growing as well. Colleges and universities are making significant investments in student persistence,

completion, advising, career counseling, financial literacy, and other academic services to ensure student success.

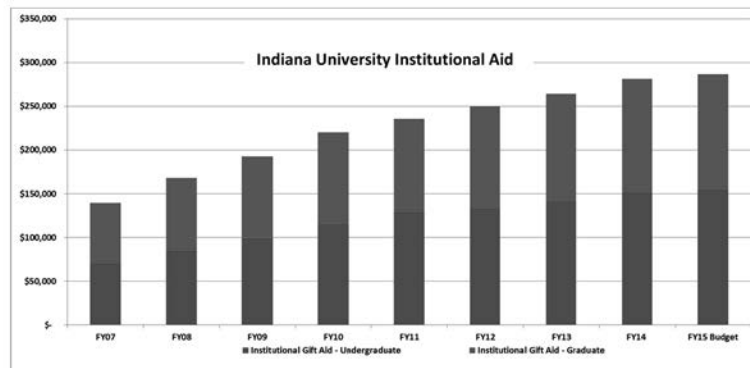
Indiana University has several initiatives directed at student affordability that are representative of initiatives across higher education:

- **Tuition increases are at historical lows.** Note that in each of the time periods noted above, beginning in the late 1970s (as far back as we have captured this data), average tuition and fee increases for both resident and non-resident undergraduates has declined.



- **Institutional aid at Indiana University** has doubled for both undergraduate and graduate students since fiscal year 2007 with the total fiscal year 2015 budget close to \$300 million. Resident undergraduate aid has tripled during this timeframe.

- Indiana University has also put **student financial literacy** front and center with targeted investment, programming, and enhanced business processes to educate students on debt optimization and loan default aversion. Results have been notable with total debt for graduate and undergraduate students **down \$82.5 million, or 16.2 percent over the past three years.** Student loan defaults have also had material decreases across all campuses. A key focus of our financial literacy education is the reduction of "lifestyle" borrowing to minimize the overall cost of college.



Additionally, at Indiana University, **administrative costs have decreased as a percent of student fees**, even with the investment in compliance and technology. Average absolute salary levels across all significant income tiers are higher for faculty than for staff and the number of faculty in higher income tiers greatly surpasses the number of staff.

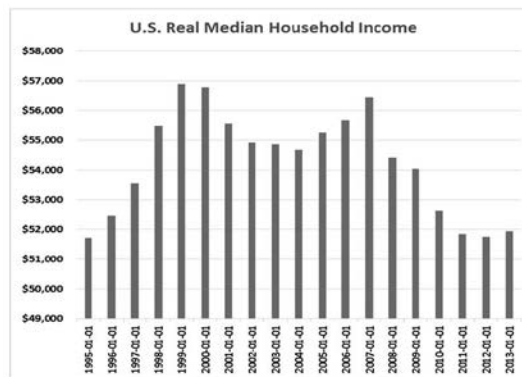
What is impacting student affordability?

The cost of college and students' ability to pay has gained the national spotlight in the aftermath of the 2008 financial crisis. Headlines tend to isolate and simplify the problem as rising tuition leading to student debt. But student affordability issues are the result of many macro- and microeconomic issues.

As Robert Archibald and David Feldman highlight in *Why Does College Cost So Much?* one must consider higher education costs within the broader economy. In practice at IU, this means that we look at every line of our income statement and balance sheet to optimize any factor for which we are responsible while examining all factors outside our purview to help students navigate their future.

In addition to the shift in cost from state subsidy to the student, there are several other factors contributing to student affordability. It is important to consider the ways in which students and families finance an education. Financing options can include current income, savings, home equity, student debt (other types of debt), grants, and scholarships.

Affordability has been significantly impacted since the early 2000s as real family income has remained stagnant. U.S. real median household income has hovered around \$52,000 since 1995.



Family net worth has been impacted by stock market volatility as well. From 2001-2012, the Standard & Poor's Index ended calendar year 2012 only slightly higher than it started calendar year 2001. This would have impacted family college funding from savings as well as donor giving to support the endowment.

Where are we now?

Institutions of higher education across the nation have adjusted their business models post-financial crisis. Student affordability has been negatively impacted by both macro-

and micro-economic forces. Institutions have put significant "skin in the game" with historically low tuition increases, significant investment in institutional aid, reduction in cost through operational efficiency initiatives, and investment in programming for student welfare and success. Attention to accessibility has never been higher and the focus on persistence/ completion has never been greater.

What role do endowments play?

It is important to note that as state subsidies have declined and pricing pressure has grown, philanthropy has gained significant importance. Philanthropy is a major factor in IU's ability to increase accessibility to our institution over the past decade.

A key societal benefit of universities is to inspire knowledge breakthroughs and provide access to education. Endowments offer donors the opportunity to support these societal needs in perpetuity. Through endowments, our donors provide students and faculty the means to change the world for the better through education, research, and public service. In many cases, universities conduct research and provide financial support to researchers that would not typically be funded by private industry or government funding, but might not be possible without donors' gifts.

At IU we also invest for the long-term; part of our strategic financial planning includes oversight and prudent management of our endowment. Endowed funds, established contractually with donors, represent the institution's promise to donors to use income and investment gains generated by their gifts to support an aspect of our university's mission.

What is an endowment?

An endowment is a collection of funds provided by donors to secure long-term institutional strategic goals. Most endowments are comprised of hundreds, or even thousands, of individual funds that range in size from less than \$10,000 to more than \$1 million—there are approximately 8,000 at Indiana University. Endowment funds are created with legally-binding agreements between donors and institutions.

Charitable giving directed toward endowments are part of a very successful formula the government has in place to leverage private investment in the American college and university sector, where our institutions use those resources to ensure they continue to be viewed as the finest educational institutions in the world.

Most individual funds have a specific, donor-directed purpose (e.g., research, financial aid, public service) and these funds represent the institution's promise to donors to use income and investment gains generated by their gifts to support an aspect of the university's mission, usually **into perpetuity**.

I'd like to highlight just two of our endowed funds at Indiana University:

- Jesse and Beulah Cox gifted IU with more than \$92 million dollars for a scholarship endowment that currently provides 100 Indiana residents access to an IU education. Jesse Cox learned what hard work meant as a child working on a farm and came to believe that, "Accumulated knowledge is the greatest key to a future of happiness." Thus, he directed his wealth to this public purpose through the establishment of this gift.
- Another gift, established in 1990, the Wells Scholars Program has launched the careers of 557 students who have, for example, gone on to be the first concertmaster of the Berlin Philharmonic, a Native American rights attorney, an endowed professor at Yale, a member of the Committee on Homeland Security, a Foreign Affairs Officer, and a pediatric researcher studying youth violence.

Uniform state law provides fundamental rules for the investment of funds held by charitable institutions and the expenditure of funds donated as "endowments." Those rules support two general principles:

- Assets would be invested prudently in diversified investments that sought growth as well as income, and
- Appreciation of assets could prudently be spent for the purposes of any endowment fund held by a charitable institution.

In other words, endowment managers are obligated to support current students, but balance asset management goals to ensure there is support for tomorrow's students. These two principles have been the twin guide stars of asset management for endowments since the Uniform Management of Institutional Funds Act (UMIFA) became the law of the land in nearly all U.S. jurisdictions. The Uniform Law Commission approved the Uniform Prudent Management of Institutional Funds Act (UPMIFA) in 2006 and recommended it for enactment by the legislatures of the various states. UPMIFA is designed to replace the existing UMIFA, which was approved by NCCUSL in 1972, and has since been enacted in 49 states.

What is a spending rate?

The "effective spending rate" is the share of the endowment value withdrawn for spending on financial aid and other purposes (spending dollars divided by the endowment value). The spending rate is determined by institutions' trustees, typically an investment subcommittee of a college or university's board of trustees. About 26 percent of the largest 2014 NCSE endowments spent 5 percent or more.

The most recent NCSE study found that, from FY04 to FY14, the average spending rate fell from 4.9 percent to 4.4 percent. However, percentages can be deceiving. **Total dollar withdrawals increased from \$360.6 million to \$620.2 million** and the overall average spending from endowments **nearly doubled** from \$11.4 million to \$26.3 million.

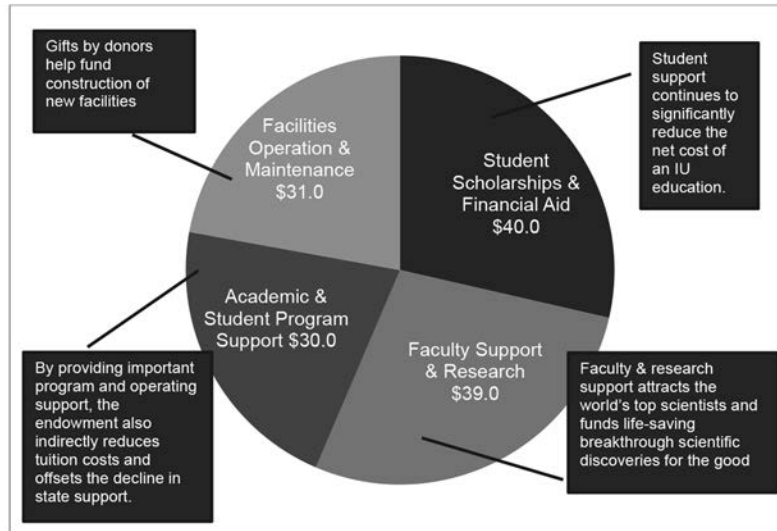
What are endowment withdrawals used for?

Most endowment spending is restricted to donor-directed purposes. **At Indiana University, unrestricted private funding support less than .1 percent of IU's annual operating budget.** Unrestricted endowment payouts at Indiana University recently supported emergency scholarships, expanding international outreach of the university and creating global opportunities for students and other priorities of the university president and board of trustees such as career support services and financial literacy programs.

The NCSE found that, in FY14, colleges received \$7.7 billion in new financial contributions to their endowments. Of those new gifts, 90 percent were restricted for a specific purpose by the donors.

The chart below describes the breakdown, by purpose area, of IU's FY2014 endowment withdrawal. Student scholarships and financial aid are a significant—and growing—area of interest for our donors. The 2014 Voluntary Support of Education Survey, conducted by the Council for Aid to Education found that 43 percent of new gifts that were restricted were dedicated to student aid. It is important to note, however, that endowment spending on other operational areas relieves tuition pressure. In other words, covering institutional expenses with endowment payouts eases pressure to increase tuition revenue.

The Indiana University Foundation, in FY 2014, provided more than \$140 million in philanthropic support (endowment and general accounts)
**amounts in millions*



Challenges Facing Institutions

Institutions across the country are facing numerous challenges: increased student expectations, rising labor costs, a growing variety of instructional delivery systems, and more stringent government regulations. These and many other forces are reshaping higher education.

Ten-year average annual endowment returns remain below the NCSE institutions' average long-term target rate of 7.4 percent (median target return rate is 7.9 percent). Moody's Investors Service continues to have a negative outlook for certain U.S. higher education sectors, due to declining revenue and falling enrollment. Standard & Poor's Rating Services also issued a negative outlook for nonprofit higher education for 2015. Student enrollments are expected to decline over at least the next decade, according to the Western Interstate Commission for Higher Education. And about half the states still spend less on higher education programs than prior to the Great Recession (2015 Grapevine report).

The way institutions respond today to each of these pressures will determine their financial condition not only now but also in the future. We take very seriously the responsibility we have in continuing to deliver on the public purpose of higher education. As economic, demographic, geographic, and cultural forces continue reshaping financial conditions, we are using the financial tools we have available to us to the best of our abilities to deliver on our missions and uphold expectations of all of our stakeholders.

Chairman ROSKAM. Thank you, Ms. McCourt.
Mr. Hartle.

**STATEMENT OF TERRY W. HARTLE, SENIOR VICE PRESIDENT,
AMERICAN COUNCIL ON EDUCATION**

Mr. HARTLE. Thank you very much, Mr. Chairman. I appreciate the opportunity to be here with you today.

The price of higher education is a huge issue, and there is no shortage of evidence that the public and policymakers are deeply worried. I talk to college and university presidents every day, and over the last 5 years this issue, the price of higher education and what can be done to minimize it, is by far the issue that has most frequently been on their mind.

Every president I know wants to find ways to minimize tuition increases while offering the highest possible quality education to their students. American higher education is a very complex and diverse industry. There are roughly 4,700 2-year and 4-year degree granting institutions in America, most of which are public and private, not-for-profit. There are about 17 million undergraduate students, more students than America currently has in high school.

Colleges and universities differ considerably from community colleges to entirely online institutions, to liberal arts colleges, to great research universities.

While it is risky to generalize about the rise in college prices given this institutional diversity, I think there are two central factors that are involved. The first is structural. Higher education is a labor intensive industry with high fixed costs, and it relies on a large number of well-educated staff. Productivity increases that might allow the same amount of product to be delivered at the same or lower cost have come slowly. There are some promising developments, but so far no panaceas.

The second major factor behind research tuition increases is a rapid decline in State support to cover operating costs at public institutions. Since the widespread creation of public college following the 1862 Morrill Act, these schools have historically charged low tuition to ensure that all citizens of the State would be able to enroll.

But for a variety of reasons over the last 30 years, State support has withered. According to one analysis, since 1988, State funding on a per-student basis has fallen by \$2,500, almost one-third. Even the National Association of State Legislatures notes that higher education has become "the fiscal balance wheel of State budgets."

So tuition in public colleges and universities, which is where 80 percent of American students are enrolled, has gone up. The posted price of tuition last year at community colleges was \$3,400, and at 4-year colleges it was \$9,100. For millions of students, financial aid reduced those numbers considerably. Still, this represents an increase in posted price of 150 percent and 225 percent, respectively, over the last three decades.

Other factors that help explain tuition increases include the exponential growth of scientific knowledge, the need to continually update and enhance campus technology, and the increasingly complex and expensive legal and regulatory environment institutions face.

Despite the desire for a simple explanation and/or an easy solution to this problem, there really are not any. Some suggest the Federal student aid drives up tuition because institutions raise their prices to capture the money. The extensive research on the issue does not suggest this claim is valid.

Another suggestion is that universities could reduce tuition if they just spent more from their endowments, but only a few schools have large endowments. Those that do spend a great deal of that money on financial aid, and even if they wanted to spend more money on financial aid, their ability to do so is significantly restricted by State law and legally binding donor restrictions.

Many institutions are taking aggressive steps to lower their cost. Purdue University, for example, President Mitch Daniels has committed the institution to maintain tuition by finding internal efficiencies, and they have not increased tuition for the last 4 years.

The "*Washington Post*" recently reported that Catholic, George Washington, and Howard Universities had all reduced the number of staff in an effort to lower their cost structure.

In another important development, tuition at public colleges in Washington State will fall 15 to 20 percent in the next 2 years, thanks to increases in State support.

I will conclude by underscoring the point that I began with. College presidents understand the importance of this issue and the extraordinarily high levels of public concern. Most presidents firmly believe that higher tuition depresses enrollment, and the vast majority of colleges and universities in the country are always anxious to increase enrollment.

But addressing the challenge posed by the high price of higher education is a complicated matter. We appreciate the willingness of this Committee to examine this issue in hopes of shedding light on the challenges facing families, institutions, States and the Federal Government.

Thank you.

[The prepared statement of Mr. Hartle follows:]



Statement of Terry W. Hartle
Senior Vice President, American Council on Education
Before the
Committee on Ways and Means Subcommittee on Oversight
Of the U.S. House of Representatives
On
The Rising Costs of Higher Education and Tax Policy
October 7, 2015

Chairman Roskam, Ranking Member Lewis and members of the subcommittee, thank you for inviting me to testify at this hearing on the rising cost of higher education and tax policy. I am the senior vice president of the American Council of Education, the major coordinating body for higher education, representing the presidents of more than 1,700 colleges and universities.

The issues of controlling costs, expanding access for low- and middle-income students and maintaining high academic quality are of the utmost importance to all college and university presidents. Each year, they face the daunting task of managing their institutional budgets in ways that address these challenging issues while attempting to limit the price students and their families pay.

Concerns about the cost of attendance and access to higher education have become major issues and a source of genuine anxiety for many American families. College presidents and academic leaders share these concerns and are continually looking for ways to reduce costs and enhance access.

Background on Higher Education

In discussing higher education finance, it is important to distinguish between cost and price.¹ Cost is what institutions spend to provide the education. Price is what students must pay out

¹ While we recognize that these terms are often used interchangeably, for purposes of this discussion we have attempted to draw a distinction.

Hartle Testimony Before Ways and Means Subcommittee on Oversight
 Page 2
 October 7, 2015

of pocket to enroll. Similarly, there is a difference between the published tuition (or “sticker”) price of tuition and the net price. Only about 25 percent of students pay the published price.

For public and nonprofit colleges, the basic financial model is cost of producing the product minus subsidies equals the price families pay. Those subsidies can be state funding, financial aid, endowment earnings, gifts from alumni and friends, and auxiliary enterprises such as college bookstores. So the price paid by families is a function of the cost of providing the education and the subsidies available to the institution and the student.

- According to the Department of Education, in 2013–14 there were 17.5 million undergraduate students enrolled in postsecondary education—13.4 million of them attending a public college or university and 4.1 million attending a private institution.
- Those students were enrolled at 4,724 degree-granting, federal financial aid-eligible institutions, of which 691 are public, four-year institutions; 934 are public, two-year institutions; 1,675 are private, nonprofit institutions; and 1,424 are for-profit institutions.
- According to the College Board, in 2014–15 the average published tuition at public, four-year institutions was \$9,140. The average published tuition at community colleges was \$3,350. The average published tuition at private, nonprofit schools was \$31,230.
- But factoring in student aid changes the picture. According to the College Board, students at public, four-year schools faced a net price of \$3,030 per year on average; and students at private, nonprofit four-year schools paid a net price of \$12,360 on average.
- In the last decade, published tuition (adjusted for inflation) at public, four-year schools increased by 42 percent on average, while net price grew by 32 percent. At private, nonprofit four-year schools, while the published tuition increased by 24 percent, the average net price actually decreased by 13 percent.
- The total amount of institutionally provided student financial aid has nearly doubled over the last 10 years, growing faster than the increase in published tuition. Indeed, the investment by colleges and universities in grant aid increased from \$25.2 billion in 2003–04 to \$48.2 billion in 2013–14.
- About 40 percent of students who earned bachelor’s degrees in 2012–13 from public and private nonprofit institutions did not take out student loans. Those who did borrowed an

Hartle Testimony Before Ways and Means Subcommittee on Oversight
 Page 3
 October 7, 2015

average of \$27,300, and 72 percent of them borrowed less than \$25,000. Only 2 percent of undergraduate students borrowed more than \$50,000.

- Perhaps surprisingly, borrowers with the smallest amount of debt are the ones most likely to default on their loans. According to a recent analysis by Susan Dynarski of the University of Michigan, the majority of defaulters (51 percent) left college with less than \$10,000 in student loans.

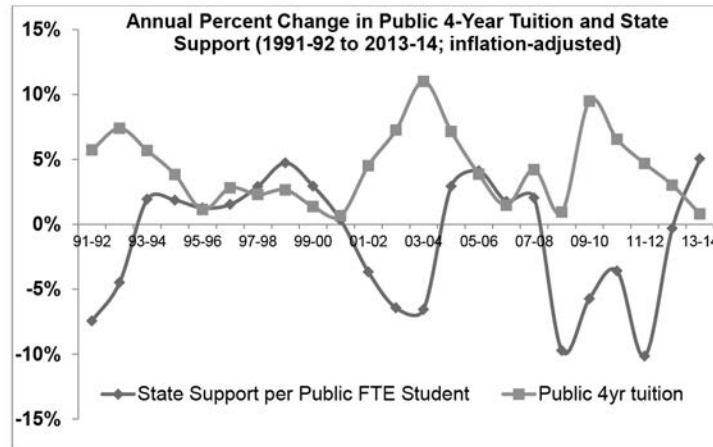
Why College Costs and Prices Go Up

Fundamentally, higher education is a very labor-intensive, knowledge-driven enterprise that relies on a highly educated workforce. Productivity gains come very slowly. While there are a number of reasons for rising college prices, there are four particularly critical drivers:

State Appropriations

The biggest factor driving price increases for most American families is the steep cuts by states in operating support for public higher education. In the last 25 years, states have systematically reduced spending on higher education, resulting in increased tuition at public institutions to offset the reduced state revenue. According to the State Higher Education Executive Officers Association (SHEEO), since 1998, state support on a per student basis has fallen by 29 percent (after inflation). Indeed, there is a clear, direct and inverse relationship between state appropriations and tuition increases. When state support goes down, tuition almost always goes up. Because state funding is often the largest revenue source for many public colleges, a 1 percent decrease in state appropriations can result in a 3–5 percent increase in tuition. The chart below makes clear that when state support goes down, as it did in the early 1990s, the early 2000s, and during the Great Recession of 2008, tuition increases. Trend lines from community colleges, though not displayed here, are even more pronounced.

Hartle Testimony Before Ways and Means Subcommittee on Oversight
 Page 4
 October 7, 2015



Source: College Board, 2014.

In 2010, state and local support for general higher education operations fell to a 25-year low in inflation-adjusted terms. During the same time period, full-time equivalent enrollment increased by 61 percent. From 2002–03 to 2012–13, state appropriations as a share of institutional revenues per student dropped from 68 percent to 53 percent at public institutions. As a result of declining state support, the share of the total institutional revenue from tuition rose from 32 percent to 47 percent at public institutions over the same period. Between 2007–08 and 2013–14, state appropriations for higher education per student declined by 19 percent in real terms, the largest three-year decline in 30 years.² In many cases, the decision to cut state operating support is accompanied by an explicit decision to raise tuition as a revenue offset. The upshot is that students face higher prices.

Labor

Higher education is a labor-intensive industry that depends on highly educated human capital. College graduates comprise almost 70 percent of the four million people who work for colleges. Higher education institutions typically spend 60 percent to 70 percent of their budgets on

²All figures in the above paragraph are drawn from the following report: SHEEO. 2014. State Higher Education Finance: SHEF: FY 2014.

Hartle Testimony Before Ways and Means Subcommittee on Oversight
 Page 5
 October 7, 2015

human resource costs. Colleges and universities compete with the private sector to hire outstanding individuals—such as engineers, biologists, chemists, computer scientists, doctors and lawyers—for faculty and administrative positions and must be prepared to pay market-level wages. In recent years, institutions, like many other employers, have faced sharp increases in benefit expenses that now make up roughly 25 percent of total human resource costs.

As noted earlier, productivity gains come slowly, and technology has not yet proven to be a fully adequate substitute. Efforts to increase productivity or reduce academic personnel costs by increasing class sizes or hiring fewer full-time faculty can have a direct, detrimental impact on academic quality and are very unpopular with students and the public. Further, continually increasing demands for more non-instructional academic support services (e.g., counseling, health services and campus security) has led to the hiring of more people. According to a 2014 Delta Cost Project report, wages and salary expenditures for student services were the fastest growing salary expense across many types of institutions between 2002–12. This further drives up the prices confronting students.

Technology

Knowledge in most scientific disciplines doubles every seven to 10 years. Whole new fields of science—such as nanotechnology—have emerged from obscure specialties to essential fields of study that can be found at most institutions. The cost to update equipment and instruments vital to undergraduate teaching, such as electron microscopes and DNA sequencers, can be extraordinary. The cost of maintaining current scientific resources also can be enormous. A single example: In 1940, an annual subscription to *Chemical Abstracts*, an essential resource that monitors, abstracts and indexes the world's chemistry-related literature, cost \$12. In 1977, it cost \$3,500, and the price increased to \$17,400 in 1995. This year, a subscription to *SciFinder*, which superseded the old *Chemical Abstracts*, cost one institution that we contacted \$64,000 per year.

In addition, with the rapidly changing nature of information technology (IT), the technological expectations and requirements of students, faculty and staff are rising. Beyond initial costs for IT infrastructure, a significant investment of institutional resources goes to creating and constantly upgrading technology-enhanced instruction and research media, student services and faculty and staff training. Today's college students expect institutions to provide information and technological services that allow them to access instructional resources and campus services anywhere and anytime. This is evidenced by the increasing use of wireless classrooms, lecture

Hartle Testimony Before Ways and Means Subcommittee on Oversight
Page 6
October 7, 2015

capture and podcasting, interactive whiteboards, virtual classrooms, mobile apps and e-portfolios, course management systems, content management systems, student monitoring and support systems and so on. No college or university equipped with scientific and technological resources from 2005 can meet the needs of students in 2015, let alone 2025. In addition, because schools do so many different things, their technological needs are not restricted to purely pedagogical technologies. Institutions need everything from modern laboratories to accessible transit schedules.

Government Regulation

Colleges and universities are among the most heavily regulated entities in the United States and are subject to a complicated web of regulations from both state and federal governments.

In 2012, Hartwick College, a modestly sized liberal arts college of 1,500 students in upstate New York, undertook a comprehensive study of its compliance-related activities. It concluded that the costs associated with federal regulations, mostly from the Department of Education, equated to roughly 7 percent of its operating budget.

Sometimes, colleges impose these costs on themselves. For example, the continual efforts to keep students safe on campus recently led Swarthmore College, with an enrollment of 1,500 students, to create five new staff positions as part of its comprehensive action plan to address sexual assault. Swarthmore is now widely regarded as having an exemplary policy for dealing with sexual assaults. Still, hiring five new employees, especially at a small college, increases personnel costs.

I must underscore that regulation is not bad or wrong. Accountability is critical, and regulations are essential to protecting students and ensuring proper stewardship of taxpayer funds. But regulations that are unnecessarily burdensome and duplicative also drive up compliance costs, impede the pursuit of organizational efficiencies and, ultimately lead to higher college prices, without providing meaningful benefits.

Some Misperceptions

Now that I have discussed the major drivers of college costs, I think it is important to address some misperceptions. It is commonly claimed that salaries paid to college presidents and football coaches and investing in campus amenities significantly contribute to higher overall tuition costs. This is simply not the case.

Hartle Testimony Before Ways and Means Subcommittee on Oversight
 Page 7
 October 7, 2015

Take presidential salaries. While we often focus on the few college and university presidents who earn seven-figure salaries, the median base pay for public college presidents in 2014 was \$400,000, according to *The Chronicle of Higher Education*, which surveyed the 238 CEOs from the largest public institutions and systems. The median base pay for private college presidents in 2012, the *Chronicle* reports, was about \$313,000.³ And the American Association of Community Colleges reports that the median pay for two-year college presidents is about \$184,000. It is important to remember that these are the CEOs of institutions with thousands and sometimes tens of thousands of staff, faculty and students and responsibility for every aspect of campus life 24/7. It also is worth noting that college presidents are more likely to be paid less than \$55,000 a year than they are to make \$1 million or more.

On the topic of coaches, the salaries of some Division 1 football coaches can be eye-popping. The median salary for a D-1 football head coach is about \$1.5 million, according to a *USA Today* database.⁴ Most of their salaries typically come from sources outside the university operating budget, such as booster funds and television revenue, sports camps, endorsements and apparel and TV/radio show deals. But out of the 4,700 institutions in the U.S., just over 100 have major D-1 football programs. To put the pay of football coaches in a broader context, a *Chronicle of Higher Education* database showing the median salaries of higher education professionals for 2014–15 puts the median salary of the head football coaches among all institutions at \$105,500, which includes D-1 coaches.⁵

On the topic of campus amenities, much has been made about the costs attached to things such as climbing walls, lazy rivers and allegedly luxurious dormitories. Not very many campuses have these types of amenities, and the campuses that do often have them because the students want them. For instance, Louisiana State University at Baton Rouge embarked on an \$85 million upgrade to its student recreational facilities, including a climbing wall and a lazy river in the shape of the school's initials. The student government voted to fund the project by quadrupling student fees, meaning students voluntarily paid \$1,080 more over four years than they would have under the old fee structure.⁶

Many institutions that add amenities like this do so because it helps in student recruitment. In recent years, a number of colleges and universities have built or refurbished student recreation

³ Executive Compensation at Public and Private Colleges, *The Chronicle of Higher Education*, June 8, 2015.

⁴ NCAA Salaries, *USA Today*, 2014.

⁵ Median Salaries of Higher Education Professionals, *The Chronicle of Higher Education*, March 30, 2015.

⁶ Lazy Rivers and Student Debt, *Inside Higher Ed*, June 15, 2015.

Hartle Testimony Before Ways and Means Subcommittee on Oversight
 Page 8
 October 7, 2015

centers and found that doing so helped attract students. According to *Business Officer* magazine, “the payback on fitness-related facilities related investments is value for students plus added vigor to recruitment and retention.”⁷

In any event, such projects are a tiny piece of overall college costs, not a significant contributor to higher tuition, as higher education economics experts such as David Feldman of William & Mary and Jane Wellman of the College Futures Foundation have noted.⁸

It is also important to note that the American higher education landscape is wide and diverse, made up of many different types of institutions with many different academic missions and campus cultures. Nobody is forced to attend a particular college. Anyone philosophically opposed to attending a school with a highly paid football coach or a lazy river can, and should, enroll somewhere else.

The Role of Endowments in the Financing Equation

Some suggest that one way for colleges and universities to manage these rising costs and resulting tuition increases is by spending more of their endowment resources. To some extent, this suggestion is based on a limited understanding of endowments.

First, the vast majority of the nation’s 4,700 colleges and universities do not have significant endowments. According to the U.S. Department of Education, in 2012–13 the median endowment for private, four-year colleges was \$26.2 million and for public, four-year colleges was \$25.3 million. According to the National Association of College and University Business Officers, in 2014, only about 600 institutions, or about 13 percent, have endowments over \$50 million. Two percent of all colleges and universities—89 institutions—hold approximately three quarters of all endowment assets.

It is important to note that the few colleges and universities with large endowments already use their endowment resources to provide substantial student financial aid to enhance access, particularly for low- and middle-income students. Moreover, relying on endowment spending and other private resources, a number of colleges and universities are replacing loans with grants as part of their student financial aid packages. These institutions have successfully managed their endowments to provide resources for the benefit of current students and society, while also protecting the needs of future students. For example, at Princeton University in 2014–15, the

⁷ Karla Hignite, *Business Officer* magazine, July/August, 2006.

⁸ Lazy Rivers and Student Debt, *Inside Higher Ed*, June 15, 2015.

Hartle Testimony Before Ways and Means Subcommittee on Oversight
 Page 9
 October 7, 2015

average aid grant covered 100 percent of tuition for freshmen receiving financial aid. In addition, 83 percent of recent Princeton seniors graduated debt free, and for those seniors who borrowed, the average total indebtedness was \$6,600. At Vassar College, which had an endowment valued in 2014 at approximately \$970 million, more than half (56 percent) of Vassar's first-year students received some grant aid from the institution. The average institutional grant was \$40,000 per student.

Second, an endowment is not a single entity that can be used for any purpose like a checking or savings account. Rather, it is a collection of many separate funds that are invested together like a mutual fund. Harvard University's endowment, for example, is really 12,000 separate funds. In addition, the bulk of university endowments—at many institutions, 70 percent or more—are restricted funds, which means they can only be spent for legally binding purposes that have been specified by the donors. For example, donors may endow a chair in a particular academic field, give money for specific library collections, designate gifts for academic research, or endow student aid for students meeting particular criteria. Several years ago, Princeton was embroiled in lengthy and expensive litigation after an heir claimed that the university was not spending a charitable gift consistent with the donor's intent.

Finally, state laws impose important fiduciary duties on college trustees regarding the management of their endowments. Specifically, trustees have a legal responsibility to manage and spend endowment assets consistent with donor intent to ensure both the long- and short-term needs of the institution and its present and anticipated financial requirements. Moreover, they are legally obligated to invest endowment assets prudently while also making every effort to achieve as substantial a return as prudently possible.

Federal Financial Aid and Rising Tuition

A common if unproved assumption is that federal financial aid drives up tuition. Called the "Bennett Hypothesis" after former Education Secretary William Bennett, this has never been proven, even after numerous exhaustive studies. A landmark, congressionally mandated study on college costs conducted by the Department of Education found that increases in federal financial aid had absolutely no impact on tuition at any type of institution, public or nonprofit private.⁹ In testimony before the Senate Finance Committee, Harvard Professor Bridget Terry Long found

⁹ National Center for Education Statistics, U.S. Department of Education, 2001. *Study of College Costs and Prices, 1988-89 to 1997-98*, Executive Summary, p. X, pp. 99-102, 133. See also, Wellman, Jane V. 2008. *Cost, Prices, and Affordability: A Background Paper for the Secretary's Commission on the Future of Higher Education*.

Hartle Testimony Before Ways and Means Subcommittee on Oversight
 Page 10
 October 7, 2015

"[c]oncerns about colleges raising tuition prices in response to federal aid appear to be largely unwarranted."¹⁰ In more recent extensive analysis of the issue, economists Robert B. Archibald and David H. Feldman at William & Mary not only found no relationship between Pell Grants and increases in tuition at public universities, but instead discovered a reverse effect at private institutions: Pell Grant increases generally *reduced* private sector tuitions.¹¹ In 2014, after reviewing nine methodologically sophisticated studies that investigated the potential causal link between college prices and financial aid, the Congressional Research Service concluded "there is not a consensus, nor even a consistent set of findings, on the relationship between federal financial aid and college prices."¹²

A recent preliminary study by the Federal Reserve Bank of New York found that colleges and universities respond to increases in federal student aid by increasing the tuition they charge their students. This study, in its current form, suffers from three shortcomings. First, it is focused solely on the published price, thus it overstates the price families actually pay because only one-quarter of full-time undergraduates pay that price. Second, the report states that institutions raise published tuition by 55 cents for each additional Pell Grant dollar received by their students. This finding can only be described as a spurious correlation given that tuition is simply not a factor in the Department of Education's calculation of the amount of an individual student's Pell Grant. Finally, the reported findings result from a model that only considers the effects on published tuition of three federal student aid programs: Pell Grants, and subsidized and unsubsidized Stafford loans. Other factors that influence the price that students and their families actually pay are excluded, including state support and financial aid that institutions provide from their own funds, to name just two.

Institutional Cost Cutting Efforts

Colleges and universities have taken a wide range of steps to contain and cut costs, as well as help students pay for their education. On the cost-containment side, these steps have included: layoffs, pay or hiring freezes; improving administrative efficiency; reducing course offerings,

¹⁰ *College Tuition Pricing and Federal Financial Aid: Is there a Connection?*, Before the U.S. Senate Committee on Finance 1, 2-3 (2006) (statement of Dr. Bridget Terry Long, Associate Professor of Education and Economics, Harvard University Graduate School of Education).

¹¹ Archibald, Robert B., and David H. Feldman. 2011. *Why Does College Cost So Much?* New York, NY: Oxford University Press.

¹² Cong. Research Serv., R43692, *Overview of the Relationship between Federal Student Aid and Increases in College Prices* 29 (2014).

Hartle Testimony Before Ways and Means Subcommittee on Oversight
 Page 11
 October 7, 2015

enrollments, or full-time faculty; eliminating academic departments; and imposing budget cutbacks and reallocating resources to pay for other institutional needs. For example, at Purdue University, President Mitch Daniels has committed the institution to maintaining tuition by finding internal efficiencies—and Purdue has not increased tuition for the last four years. Other universities, including Michigan State University and the University of Maryland have undertaken similar efforts in the past. The *Portland Press Herald* reported that the University of Southern Maine last year eliminated 51 positions and closed five academic programs. Tuition at public colleges and universities in Washington state will fall 15 to 20 percent over the next two years, thanks to increased state support for higher education.

Private, nonprofit colleges and universities around the country are identifying and implementing institutional strategies designed to make college more affordable and accessible for students and families. This includes affordability initiatives that demonstrate the creative ways in which private, nonprofit colleges are working to keep out-of-pocket costs as low as possible. These initiatives are part of a growing campus affordability trend that has accelerated since the economic downturn.

Converse College in South Carolina has frozen its tuition for 2015–16, after cutting it by over 40 percent in 2014–15. In fact, Converse is one of several institutions that cut tuition for 2014–15 by more than 20 percent. The University of Dayton has a fixed-net tuition guarantee, meaning students will have no annual increases in what they pay after student aid is taken into account. Many institutions, like Huntingdon College in Alabama and Hiram College in Ohio, have fixed-tuition structures for students for all four years. In Iowa, St. Ambrose University guarantees that their students will graduate in four years.

In addition to tuition cuts, freezes and fixed-tuition guarantees, private, nonprofit institutions are implementing a range of other affordability measures, such as military scholarships; public-university price matches; loan caps; replacing loans with grants; and loan repayment assistance programs.

Conclusion

There is no question that the rising price of college is a source of great concern and anxiety among students and their families. College presidents and academic leaders share that concern. As I have discussed in some detail, multiple, complex and interrelated factors drive tuition increases. Addressing the challenge posed by the high price of higher education is serious and complicated,

Hartle Testimony Before Ways and Means Subcommittee on Oversight
Page 12
October 7, 2015

and unfortunately does not lend itself to easy solutions. We appreciate the willingness of this committee to examine this issue in hopes of shedding light on the challenges facing institutions, states and the federal government.



Chairman ROSKAM. Thank you, Mr. Hartle. And thank you all.

You know, you have framed out some of these issues in ways that I think are very, very helpful. I think on this panel what we are interested in doing is trying to essentially pursue the Wisdom of Solomon on this. So, in other words, how do we create an environment where resources are made available to students who without those resources would not be able to have access to higher education? How do we do that in a way that does not just chase a price, basically Mr. Lucca's argument, forcing something to become more and more expensive?

Because here is what I am sensing at home, I think we are in the midst of a bubble. My wife and I have four children, and if you see Peter and Elizabeth Roskam out with a metal detector picking up loose change to pay the tuition for our children, the explanation is these incredible expenses in doing so, and writing these checks just takes your breath away.

I know I am not unique in this. I know that there are other folks on this panel and so forth, and I think that we are in the midst of something that is really, really significant.

In short, institutions by definition do not reform themselves, by and large. Congress does not reform itself. Congress reforms itself based on pressure from other institutions, and so forth.

I would submit that higher education is not likely to reform itself without pressure from other points, and this Committee has an interest particularly from a tax policy point of view. So, in other words, the question is: Does the Tax Code help create more access to higher education, or does the Tax Code hinder that? Does the Tax Code create absurdities and distortions and so forth?

So there is a lot to talk about. Before we began, I told the panel we want to flip the game board a little bit today, just to ask some of these provocative questions not for the sake of being provocative, but for provoking some reflection all the way around.

So, with that, I recognize the gentleman from Pennsylvania, Mr. Kelly.

Mr. KELLY. I thank the Chairman, and I thank the panel for being here.

I come from the private sector, and our whole model is based on some assumptions. Specifically, it is based upon predictions and projections of historical data. However, when it comes to personnel, one of the things that we have always tried to do is to hire the best people we could and then make sure that we put programs in place that set benchmarks for them to achieve because I do not know of any other way to determine if this is working or not working, and whether these are the best people to have in these jobs.

So having said that, I often wonder because I look at what is going on, and I think the Chairman was very articulate about this. This is not so much about who is making what and trying to make them look bad. This is about are we getting the best return on the investment for hard-working American taxpayers.

So it should not be an "us versus you" or a "you worried about us coming knocking at your door and trying to upend your economic model," but in my life everything has been about sustainability. Can you continue on the path that you are on and think that somehow it bodes well going into the future?

So, Ms. McCourt, having a little bit of an idea of what I do for a living, whenever we are hiring these folks, the boards are bringing people in, what are the measures? I mean, how do we look at these folks that are in these upper positions and say these are the metrics we expect you to perform to?

There is a great incentive for doing that, and it is called compensation, but how do we measure it and what do we look at?

Do we look at student graduation rates? What do we look at?

Ms. MCCOURT. Well, it is interesting you would ask that question today because our board of trustee meetings are tomorrow and the next day, and I happen to have in front of me the financial models and benchmarks that happen to be on our agenda, 8 o'clock Friday morning.

We are very benchmark driven. Our trustees are very high achieving businessmen. We have the CFO of Eli Lilly, for instance, who is on our board right now.

And when we benchmark, you know, one of the things we are very conscious about is we are not benchmarking against higher education on the business side of the institution. They want to see benchmarks against corporate gold standards. So we will go out and have benchmarking analyses done on our business operations and compare them to that, but we also set very stringent benchmarks. In fact, none of these are industry averages. They are all at a higher level than an industry average.

We also have just approved a bicentennial strategic plan, and every item in that strategic plan will have associated benchmarks, and I think you are going to see that across the industry.

The industry has shifted, and people that are being hired in on the business side are corporate.

Mr. KELLY. Is the benchmark based on the success, the graduation rate?

Ms. MCCOURT. Oh, we have many, but we do have completion, graduation, all kinds of benchmarks, but there are many based on student success, and we have fared extremely well on those.

Mr. KELLY. Mr. Galle, what Ms. McCourt has just said, is that something that makes sense to you and do you agree?

Mr. GALLE. That is consistent with some of what I have seen, yes, sir.

Mr. KELLY. Okay. I think the big question is, and Mr. Vedder, I am going to come to you also, and I think this is where we are really trying to come to, the best return on investment, because we all know the way out of poverty is education, but education for something that actually gets you to where you need to go and not just a degree that is accompanied with a lot of debt, but actually a destination that you can reach that is going to lift you out of it.

So what is your take on all of this? Because I know it is a highly competitive field. When you are looking at the people to come in and run this business now, forget about being a university, but as a business, because you are competing for the same talent that everybody else is competing for to come to something that is a real sound economic model.

So how does that figure in and how do you think that weighs when it comes out?

How do we recruit the best of the best?

Well, certainly compensation has to have something to do with it. Mr. Vedder, that is for you. Is there a different way to go about it?

Mr. VEDDER. To get better people in higher education? Is that what you are asking?

Mr. KELLY. Yes, my question is: What is the incentive to get them in?

Mr. VEDDER. Well, you mentioned two good words, Congressman. One is incentives, and another was by inference, information. How do you measure what is good in higher education? How do you know what is good?

Did Harvard have a good year last year? Who the heck would know? How would you know?

Do the seniors know more than the freshmen? We do not know that.

What happens to kids 5 years after graduation? We are starting to get that information. Finally, the Department of Education is finally grudgingly publishing data on that.

What is the rate of return on faculty research? If you write an article for the "Journal of Last Resort" that three people read and get a lower teaching load to do that, is that serving the broader issue, interest of society?

And, by the way, I have been ripping off taxpayers for 51 years. I am in my 51st year of teaching.

Chairman ROSKAM. You have the right to remain silent.

[Laughter.]

Mr. VEDDER. Yes. I will drink to that.

But I think, and I am being a little facetious here. I think it is a noble profession, and I think what we are doing is important, before Mr. Hartle has a heart attack, but we do not really know a lot.

We are in the information business, and we do not even know basic things. Students study 30 hours a week or less. That is what the Department of Labor tells us. Thirty hours a week, that is 900 hours a year. The parents work twice as many hours.

Eighth graders study 40 percent more than 13th graders. Now, does that make any sense at all? Why are we not doing anything about it?

We are not measuring all of this. I do not know if I answered your question.

Mr. KELLY. Well, the thing is the benchmarks that we use to hire the really good people, because you are in a very competitive environment, and if you are going to get the best of the best, it is not just what is in their heart and their passion for what they are doing. It is also dollars that have a little bit of influence, too. So I want to make sure we keep it in perspective because the return on taxpayer investment is what we are concerned about, and that it is fair.

Thank you.

Chairman ROSKAM. Mr. Lewis.

Mr. LEWIS. Thank you very much, Mr. Chairman.

I thank each and every one of you for being here today.

Now, Mr. Chairman, I am concerned that we are here today focusing on side issues rather than the main driver of tuition increases for most college students.

Dr. Hartle, what is the biggest factor driving the rise in tuition for most students?

Mr. HARTLE. Thank you for the question, Mr. Lewis.

As I mentioned, I think there are two fundamental issues here. One is the structural nature of higher education as a labor intensive industry.

The second and more pronounced—higher education has always been a labor intensive industry—the second and more pronounced is that States recently have begun to reduce spending substantially for public colleges and universities. Forty percent of American college students are in community colleges, public institutions. About the same percentage are in public 4-year institutions, and we have seen States cut spending now for over a generation.

We have to have some sympathy with the States. They have to balance their budgets. When State legislators look at budgets, they see four big buckets: elementary-secondary education, prisons, Medicaid, and higher education. When they have to balance the budget, higher education looks like something that has paying customers.

And the trend over the last 30 years has been down. It is a wavy line, but the line is going down.

I happened to just discover the other day that a significant number of States now spend more money on prisons than they spend on public colleges and universities. Last year for the first time in the Nation's history, public colleges and universities got more money from tuition than they received in State support.

Just the other day my colleagues and I were looking at a list prepared by the Department of Education of the 50 most expensive public universities in the country, and we happened to notice that four of them were in the Chairman's home State, Illinois. This struck us as a surprise because Illinois historically has had pretty moderately priced public colleges and universities.

So we did a little investigation, and discovered that between 2001–2002 and the present, Illinois, which has obviously had some well publicized State budget problems, has cut more than \$100 million from the budget of the University of Illinois, Urbana; more than \$100 million from the budget of the University of Illinois at Chicago and let tuition go up to make up the difference.

I can assure you that was not what presidents and managers at either of those institutions wanted, but it was a decision made by the States as part of the necessity to balance their budget.

We are seeing that to a similar degree in State after State across the country.

Mr. LEWIS. Well, thank you very much.

Ms. McCourt, do you agree with Dr. Hartle?

As a matter of fact, I visited your university a few weeks ago, had a great visit there, wonderful faculty and staff and students. Do you agree with Dr. Hartle?

Ms. MCCOURT. Yes, I do.

Mr. LEWIS. Do you have anything to add?

Ms. MCCOURT. No, I think he has articulated it very well. We are grateful for what we get from the State. There are very many competing priorities. I actually was not aware of the statistic on spending on prisons, but the decrease in State operating appropriations has had probably the single biggest factor, and I want to say on the price of higher education, not the cost.

The cost has actually not increased that much.

Mr. LEWIS. Well, thank you very much.

Now, I believe that access to affordable higher education is a right that all Americans should have regardless of their income level. The Federal Government must play a role in making college affordable and must expand, not decrease Federal student programs. Pell Grants and student loans are vital to low- and middle-income Americans.

Dr. Hartle, do Federal financial aid programs drive up the cost of tuition?

Mr. HARTLE. No, sir, I do not believe the Federal student aid programs drive up the cost of higher education. This is not a new debate. This issue has been around for more than 30 years. It has been exhaustively researched.

As I noted in my written testimony, independent studies like the congressionally-mandated study of this issue by the Department of Education were unambiguous in their conclusion that there was not a relationship between Federal student aid and tuition.

They were equally unambiguous that the single biggest driver was State budget cuts. Harvard Professor Bridget Terry Long in testimony before the Senate Finance Committee on the impact of tax credits on college tuition said, "Concerns about a relationship between Federal student aid and tuition were largely unwarranted."

I would like to submit a paper for the record written by Don Heller, the Dean of the School of Education at the Michigan State University, an education economist, which addresses this issue.

And I would also like to suggest that the Members of the Committee do two things in this regard. Do not take my word for it. Look at the report on this issue prepared by the Congressional Research Service. The Congressional Research Service evaluated the nine most methodologically sophisticated studies on this issue that they could find, and they concluded that there was not a clear or even a consistent set of findings about the relationship between Federal student aid and college and university tuition. CRS works for you.

The second thing I would ask you to do is ask the presidents and ask the trustees and ask the people like MaryFrances McCourt at the universities in your district. Ask them if Federal student aid ever comes up in discussions about tuition setting.

What you will find is that they are surprised you would even ask the question because it never comes up in the discussions.

Mr. LEWIS. Thank you very much.

I yield back, Mr. Chairman.

Chairman ROSKAM. In terms of the paper that you have requested, without objection, we will enter it into the record.

Let me just plant a seed and maybe some of the discussion as I turn to my colleagues, but, Mr. Hartle, you made a point that

higher education costs are going up because of the intensity of the labor. So I am planting seeds about things maybe to talk about further, but think about this.

So it does not seem to me that is new. So it has been intense for a long, long time.

The other thing, the lack of public support from the State legislative point of view does not explain the increase in tuition at private institutions, and it does not explain the longer term trend in my opening when I showed a 40-year trend and 2X over healthcare costs.

So maybe during my time I will come back, but that is an area that I would like to inquire about.

Mr. Holding.

Mr. HOLDING. Thank you, Mr. Chairman.

Dr. Lucca, let me ask you a hypothetical. If the government handed out \$50 credit cards that could only be used to buy milk, what do you think would happen to the price of milk?

Mr. LUCCA. It depends on the elasticity of supply, but generally you would imagine that the price of milk, unless supply can immediately adjust, would rise.

Mr. HOLDING. Right. Do you think that this \$50 credit card, this subsidy, would improve the quality of the milk?

Mr. LUCCA. Obviously not in the short run. The long run is a different question.

Mr. HOLDING. So I think what you are saying is that when the grocery store knows that buyers have the means to buy a product at an inflated cost, the seller will raise the price. Is that a correct assumption?

Mr. LUCCA. Yes, that is what basic economic theory would suggest.

Mr. HOLDING. So this makes sense when the seller is a for-profit entity and charges prices based on what the market will bear, but from listening to you and some of the other witnesses, I think this is exactly what nonprofit colleges and universities are doing.

So as soon as the Federal Government increases grants or student loan caps, colleges and universities react by raising tuition and absorbing that taxpayer money.

Now, I know you are familiar with Ronald Reagan's former Education Secretary William Bennett, who back in 1987 hypothesized that increases in financial aid have enabled colleges and universities blithely to raise their tuitions, confident that the Federal loan subsidies would help cushion the increase, and this has come to be known as the Bennett hypothesis, and you have done some work in this area.

So could you expand a little bit on the work that you have done in this area and talk a little bit more about the Bennett hypothesis?

Mr. LUCCA. Yes. So the Bennett hypothesis that many have discussed in the past is essentially the idea that financial aid, the availability of financial aid allows colleges to raise their tuition.

From the perspective of an economist, going back to your points, it is fairly standard to imagine that any sort of subsidy that will boost demand will have a price effect. It is fairly natural. It is not

that, you know, colleges are evil in any way. You know, it is just essentially supply needs to meet demand.

What is really important, I think, is to some extent distinguish short-run versus long-run effects. What our study is doing is to try to focus on the changes in Federal aid policy of the past few years. These changes have been very significant, and from the point of view of researchers, they are, you know, very useful to try to assess these potential price impacts.

And we do seem to find significant responses when we compare institutions where students are heavily dependent on Federal aid versus those that are not.

Now, Mr. Hartle has cited a number of other studies that have found results against our own findings. I think the way to reconcile these studies is to some extent the availability of data in the past versus today.

Today over the past few years, we have seen, you know, significant and discrete changes in Federal aid, and I think this is what has allowed me as a researcher to find, you know, price effects or, you know, responses of tuition as opposed to other studies that have looked at this issue in the past.

Mr. HOLDING. My undergraduate degree is in classical studies, and I think they teach classical studies today exactly the same way that they taught it 30 years ago when I was in college, and they probably teach it exactly the way that they taught it 150 years ago when a great-great-great-grandfather of mine was a classics professor.

So with the rise in increased tuition cost, do you think that students are getting a higher quality education?

Mr. LUCCA. This is an excellent and important question. Where does the money go?

In theory our study is unfortunately silent on that. You would hope that, you know, in the long run, you know, much of this additional revenue coming into colleges will be re-spent on investment for students, but there is nothing in my study that really can tell one story versus another.

Mr. HOLDING. Thank you, Dr. Lucca.

Thank you, Mr. Chairman.

Chairman ROSKAM. Mr. Rangel.

Mr. RANGEL. Mr. Chairman, I have been here in the Congress since 1971, and I cannot think of any issue more important to my country than the issue that you have raised. This is especially true in view of the fact that questions of war and peace, Presidents, Republicans, Democrats have not seen fit to bring those questions to the Congress.

I do not understand the language that they are talking about. It is my understanding that most people believe that since the Constitution did not raise the question of education, that it is a State issue. I am fortunate that I can look at this from an entirely different perspective.

I was raised in a community where I did not know anybody of my color that went to college, and the only people I knew were the recipients of the GI Bill. So I come at this with a strong, emotional bias that out of the pits of a high school dropout with absolutely no incentive to go to school, that I can sit in this body and the

question of education now becomes whether the States are not going to fulfill their responsibility and what can we do as a tax committee to provide incentives.

Health is not a national responsibility. The pursuit of happiness is not. Homelessness is not. How can we sit here and say that the cost of labor and the disparity that we have in income is going to make it possible for a guy with our salary, that you are concerned about your kids getting an education?

The numbers are actually going to show that tuition is going up, and there will not be enough savings for people that have incomes to even consider their kids going to school. Well, forget the poor and forget all of that. As a patriot, are any of you going to tell me that education is a local issue and that the States are not being responsible when we are talking about technology, science, cyber space?

Are we checking what they are doing in China and India to find out whether the local communities are supporting this?

The cost of labor, do you know how much it costs for a dumb GI to get an education to kill people? Over \$1 million. So let us not talk about the cost of labor.

And how can we even discuss this when nobody can justify why college presidents can make \$2 and \$3 million? I am not knocking if they are raising money, or coaches that make \$1 million or \$2 or \$3, \$8 million. If it is raising money, that is the private sector. Whatever they do is okay.

But who is going to tell me sitting here, just put up your hand to say that the education of Americans' ability to make a contribution to our national defense is a State issue?

Who believes that? Put up your hands. And if you don't believe it, why are we talking about tuition? Could you tell me whether or not you take an individual, an average American, and see what happens to him without an education, the costs of it? Forgetting all the emotional prison costs, I am just talking about a guy that tries to make it and he can't make it in a competitive society. Do you need a social scientist to say how much you have given to America by educating this bum and making him productive?

So I don't—I am not talking about endowments. Those that have money, you put it in the money market. It makes money, but what the heck has that got to do with education?

So I want to thank you for raising this issue. It shouldn't be before our Committee. It's a national security issue. If any of the panelists want to bring this into reality rather than talking about decreases in State contributions to education, like I'm supposed to depend on Mississippi's contribution—strike that out.

I am supposed to depend on a State Governor's contribution to make my country strong against international people that we're involved in trade with? I don't think so.

And who is talking about the costs? I am not even going to ask you what the cost of labor is in our universities. I know the cost of police, of doctors, of developers, and we have a Congressman/Chairman of the Committee, he is talking about he's concerned about his kids going to college.

So I'm going to act like you didn't testify to what we are asking you about and ask what does anybody think about the future of

education under the system that we have and where does America stand up to our competitors?

Chairman ROSKAM. Why doesn't one person take a stab at responding to that?

Mr. Vedder.

Mr. VEDDER. Congressman Rangel, I was struck by your very first sentence. In your very first sentence you said, "I didn't know any of my friends or anyone around me who went to college unless they went on the GI Bill." I think the most interesting tragedy in higher education that might be interesting to you given your remarks was that in the year you started in Congress, which was 1971, right?

Mr. RANGEL. Yes, sir.

Mr. VEDDER. In 1971, when you started in Congress, 12 percent of poor people in America, which I will define as the bottom quarter of the income distribution, 12 percent of recent college graduates were poor, came from poor backgrounds, 12 percent. Today, it is 10 percent. It is lower.

We have all of these programs, financial aid programs, all of this stuff going on, everything supposedly to help increase access and we do have more people going to college and we do have more college graduates, but in terms of bringing about equal opportunity among people, education is serving as a way to get up the ladder, to move up the ladder. I think we failed and I think part of the reason relates to the kinds of things that my colleague here was talking about. The financial aid programs haven't worked the way they were intended to work. There were unintended consequences, but that may be going too far afield.

Chairman ROSKAM. Mr. Renacci.

Mr. RENACCI. Thank you, Mr. Chairman.

I kind of want to pull this boat back to where I thought the hearing was going, which is examining whether the favorable tax treatment given the college and university is fully justified and I know we have kind of talked about a lot of good points, but that is where we're really at, the favorable tax treatment, and in the real world, where I spent 30 years before I came here, I actually operated healthcare facilities, where I had to compete against facilities that were not-for-profit. They had favorable tax consequences I didn't have access to.

There was a big advantage there that I always remember. Number one, they didn't pay taxes, and number two, they received donations/endowments. So if you think about it, they were able to receive additional revenues, which helped their cause, and they were able not to pay taxes, which also helped their revenue side. On the other side, as a for-profit businessowner, I had to make sure that I could compete against that person who had favorable tax treatment and I think that is where we want to talk. We want to get back to that.

So now we talked about universities, the private schools, and I want to talk a little bit about executive compensation because I think that is important. We are talking about costs and the costs of these universities and what is reasonable and how do we determine what is reasonable.

In my world, I had to make sure there were metrics that said this is what is reasonable and here is how we are going to get there. If you met this, you made this amount of money, and ultimately, you can make a lot of money, but you had to meet certain metrics.

In colleges, how do we determine what is reasonable? I mean we saw a slide or there was something here about executive compensation, how quickly it has grown. I think it was you, Mr. Galle, in your testimony. It has grown rapidly over the years.

So how do we justify, especially in a situation where some of these private universities are getting favorable tax treatment, how do we justify compensation? We heard that labor is a big number, but how do we justify compensation?

I will start with you, Mr. Galle. What does it take for compensation to be determined reasonable or unreasonable?

Mr. GALLE. Well, I think it is a difficult question to answer because being a university president is a difficult job that takes a talented person and I don't think that anyone in this room wants to say what someone else's labor is worth, but we do have a group of people who are pretty attached to their university and are relatively well-informed about it and that group of people are the university's alumni and its supporters.

And so the focus of my work has been in making sure that that community of people, the community of people who have reasons to care, have the information that they need to make a decision about whether the president is getting paid the right amount, and by and large, today it is pretty difficult for people to get that information. For example, it is true that presidents are often judged on a set of performance metrics, but it is very hard for someone other than on the board of trustees to know what those performance metrics are or whether the president hit them or not. And so, for me, the issue is more about transparency and less about second-guessing by folks who aren't part of the university community.

Mr. RENACCI. What is interesting is you talked about being the president of a university is a very tough job. A president of an automobile company, like Mr. Kelly talked about, or a president—all positions are tough, but you still have to have metrics to determine what they are worth and how these costs are being passed on to the students. It is part of the cost of higher education.

We keep talking about labor. You know, how many kids are graduating? Where are they going after they graduate? These should be some of the metrics. What are the universities doing? These are expenses that should be part of it, and the problem I have, and I think this is part of this hearing, is that many of these universities are getting favorable tax treatment. They are getting all these extra dollars in. So we have to consider that.

Ms. McCourt, do you—

Ms. MCCOURT. Yes, I have a couple of points.

Number one, there are many, many, many metrics that senior leadership and down are judged on in public institutions of higher education. You can peruse certain websites out there. They are very public and they are growing and business analytic tools are growing and compensation is being linked—

Mr. RENACCI. I need to—I apologize. I do have to interrupt you. I am running out of time, but isn't one of the most important comparables? So if one university raises theirs up, I have to make sure—

Ms. MCCOURT. Let me use one statistic. We are talking about—I want to make sure we are not talking about the .001 percent of a couple of very large private institutions that I don't think the compensation is even that high, but when you look at several billion dollar organizations and when you look at the highest paid CEOs on the corporate side earning compensation packages north of \$12 million, for instance, the Indiana University president makes \$600,000 to manage a several billion dollar organization of multiple businesses with performance metrics.

So I think we need to be careful to stay—stick to the data. That information—most institutions of higher education are public and that information is public.

Mr. RENACCI. One thing I would add, and I know I have run out of time, Mitch Daniels demanded that a portion of his salary be contingent on meeting certain goals. I think that is important.

Ms. MCCOURT. Absolutely. We do the same.

Mr. RENACCI. Thank you. I yield back.

Chairman ROSKAM. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

Excessive, exorbitant corporate CEO salaries and soaring prices for consumers are certainly problems and they rarely get any attention in this Committee. I have offered legislation to eliminate or reduce the tax subsidy for excessive corporate salaries. The Committee's not interested. We see price increases in the pharmaceutical industry of 5,000 percent overnight, bankrupting families. The Committee has been uninterested in dealing with this problem of soaring prices, but we have today's hearing and it does address an important problem.

There are families across America that are encountering major economic obstacles to helping their child get all of the education that that child is willing to work for. Many colleges and universities with spiked—increases in tuition are part of the problem and I think we need to look at our Federal aid policies and consider that aspect of the problem, but I think much of the focus of today's hearing is misdirected.

The basic reason that tuition is going up is not because the Federal Government is doing too much to help students, but because the States have been doing too little. We have seen a steady decline in State support for the 80 percent of college students that attend a public or State university. Some States, like Texas, have cut their support for public education, for higher education, even again this past year, and a report out in the last week identifies 11 States—that is the American Academy of Arts and Sciences—11 States that are spending more on their prisons than they are spending on their higher education institutions.

Within the last week, the University of Texas System Board of Regents gave approval for another increase in tuition for the next school year and the chancellor, William McRaven, said that the school needed the increase because of the decline in per-student State appropriations by the legislature over the last decade.

So that has us to where we are today and because they misdiagnosed what ails higher education and the families that want to get it, they are also applying the wrong remedies and the Republican remedy is reflected in the Republican budget agreement this year. They proposed to solve this problem by cutting about \$200 billion from higher education support and while the final agreement is silent on how they would do that, many of their Members have been very vocal about how they would implement that \$200 billion cut. They would reduce or eliminate Public Service Loan Forgiveness that allows students to have the choice of serving their communities in underserved areas in health care and a variety of other areas, shrink income focused repayment plans, and freeze Pell Grants for 10 years while cutting \$90 billion in funds for those grants alone.

Those are the kind of remedies that the Republicans have been offering, the kind of remedy they have offered in the Senate is to block our efforts to reduce the cost—to let people who are overwhelmed with student debt do something about it by reducing interest rates. The change that was proposed there would save \$2,000 per loan for an estimated 25 billion borrowers nationwide. That is the kind of solution that we need.

My efforts to make the American Opportunity Tax Credit permanent so our families could get at least \$2,500 off their taxes, blocked in this Committee.

If we want to focus on where Federal dollars are being misdirected, we might focus more specifically on what are little more, in some cases, than mail-order diploma mills and the attempts of the Department of Education to do something about it. The President's general employment rule requires that these schools demonstrate that they are getting their students into some gainful employment, and yet, some of the same people who want to cut student financial assistance are the folks that support siphoning off as much money as possible to these for-profit schools without looking to see whether they are actually producing results for the families and especially for many of our veterans who sign up for these programs.

So I believe we need to do more to afford opportunity, the very kind of opportunity President Johnson had in mind when 50 years ago in San Marcos, Texas, he signed the Higher Education Authorization Act that is about to expire, but we need to do it in a more constructive way than is being done in today's hearing.

And I yield back.

Chairman ROSKAM. Thank you.

Mrs. Noem.

Mrs. NOEM. Thank you, Mr. Chairman.

You know, a lot of colleges' and universities' endowments, we have made very clear at today's hearing, receive specific tax advantages and when a donor gives money that money is not subject to taxes. The institution doesn't have to pay taxes on the gift and if it is invested, the institution doesn't have to pay taxes on the returns from that investment.

Currently, I was surprised to learn, over 90 different institutions have more than \$1 billion in endowment funds and we are talking

about very substantial tax benefits then to those institutions and so I wanted to visit this topic a little bit more.

With tuition costs going up and such high endowments, Dr. Vedder, you have talked a lot about research that you have done, but I want to find out if you specifically think that institutions are using these endowment funds to benefit students specifically?

Mr. VEDDER. I suspect most institutions feel that they are using the endowments to serve students and it is a little—I am still in the middle of research in this and I don't feel I have all the answers.

Mrs. NOEM. Well, do you have some statistics on how they are spending endowment funds?

Mr. VEDDER. Well, we know, for example, that some endowment monies do go to support student financial aid, which is directly, you might say, student friendly, aimed to lower costs, and so forth.

Mrs. NOEM. Is some 10 percent or—

Mr. VEDDER. No, I—

Mrs. NOEM [continuing]. Fifteen percent?

Mr. VEDDER [continuing]. In my estimations that I have done, we estimate between 15 and 20 cents out of each endowment generated dollar of income goes for that purpose. Now, that is not trivial, but it is not the major “aww” factor. We are finding a lot of money going to support things like student services. I mean at least we see an association between endowment size and spending on student services.

Now, that is a—that may be student oriented, but it may not be too academically oriented. For example, some of that money might be going to help support sort of luxury living on the parts of the students in some fashion.

Mrs. NOEM. Why do you think school rankings give so much weight to the size of endowment funds?

Mr. VEDDER. Rankings do not. By the way, I do the rankings for *Forbes* magazine, so I—

Mrs. NOEM. Okay.

Mr. VEDDER [continuing]. Should be—full disclosure here.

Mrs. NOEM. Okay.

Mr. VEDDER. I actually do—I am a ranker—

[Laughter.]

Mrs. NOEM. Okay. Thank you.

Mr. VEDDER [continuing]. Which is better than being a rapist or something, but not much in the eyes of the higher education community.

I don't know of a single ranking that uses endowment size as a direct variable in the analysis, but it is true that spending on whatever can influence rankings. The *U.S. News* rankings, for example, give—you get a higher ranking if you pay your professors more, if you have more faculty in relation to student size, and so forth, all of which, you know, improve your rankings. So—

Mrs. NOEM. Have you seen a correlation between student outcomes and the size of endowment funds a university raises?

Mr. VEDDER. I have not. That is the point I was making. I have done—using the imperfect rankings that I do, and they are imper-

fect in large part because of data limitations, as I say, we don't know whether seniors know more than freshman.

Mrs. NOEM. Uh-huh.

Mr. VEDDER. I mean until you know basic things, like are kids learning in college, it is very hard to come up with a full assessment of the quality of an institution, but given what we know and looking at what students think are important, I can say that there seems to be very little relationship between what students think are important in their learning and endowments.

Mrs. NOEM. Okay. Thank you.

Ms. McCourt, can you tell me why universities and schools don't spend down their endowment funds?

Ms. MCCOURT. There are contractual obligations with donors putting money into these long-term investments, you know, and I would say that the picture we are missing is sustainability. Donors want to make sure that there is sustainability and there is a term called intergenerational equity. They want tomorrow's students to have the same benefits as today's students and most donors are very, very interested in that. They don't want to see us—you know, they wouldn't be giving the dollars today to just have it spent.

Mrs. NOEM. Is there a standard? Is there a specific level of endowment funds that should be in place to guarantee that its intergenerational benefits will be there?

Ms. MCCOURT. Well, that—and that is how that—distribution rate it is called—when we are referencing this 5 percent number, that is how that is determined. They will look at long-term investment returns with a lot of sophisticated modeling and then they will say, all right, what is that return to keep a level of funding that will go into perpetuity and they back into what that spending rate is.

Mrs. NOEM. And some endowment funds are restricted on what they can be spent on, correct?

Ms. MCCOURT. Most are. Most are restricted. At Indiana University, I think 98 percent are restricted.

Mrs. NOEM. Do you feel that is appropriate? I mean—

Ms. MCCOURT. I—

Mrs. NOEM [continuing]. A lot of times, I will argue for more local control because they best know what their needs are to meet the students where they are at and help them be successful. So to have restricted funds, I think ties the hands of some of these—

Ms. MCCOURT. Well, but these are—we are carrying out the will of donors and donors feel very passionate about what they are giving money toward and so—and I will say most of it goes to the scholar—you know, when I—I am looking at ours right now. I mean data is behind every single thing I am saying today.

Mrs. NOEM. So you believe restricted funds may be just as beneficial as unrestricted funds?

Ms. MCCOURT. Absolutely. Absolutely. Yes.

Mrs. NOEM. All right.

Mr. Chairman, I will yield back.

Chairman ROSKAM. Thank you.

Mr. Crowley.

Mr. CROWLEY. Thank you, Mr. Chairman, and I thank all the witnesses. Thank you, Mr. Chairman, for holding this hearing today and thank you to all the witnesses for providing your testimony before us.

I am glad that my colleagues on the other side of the aisle are finally taking note of how important it is to address the issue of higher education affordability, although I do take some interest in noting the suggestion that maybe eliminating Pell Grants will somehow force private higher education in the country to actually reduce the amount of tuition is very interesting.

It is an issue that my Democratic colleagues feel has not received the due attention it really has deserved, but I must say there is so much more this Committee, the most powerful Committee in Congress, could focus on with—as crucial an issue as this. Instead of getting bogged down in picking at taxes and status or the use of endowments, we could discuss how to strengthen the Pell Grant program as opposed to weakening it or eliminating it or how to build up the progress that Democrats have made years ago in making student loans work better for students and families alike.

Surely this hearing can't be my colleagues' only response to calls from millions of struggling, middle-class, hard-working Americans who are concerned about how they will put their children through college. If anyone turned on C-SPAN today hoping to find out more about the other side's plan to actually make higher education more affordable, I think they are all going to be, if not already, very, very disappointed. There is no plan.

Mr. Hartle, in your testimony, you discussed the various restrictions on endowments and you clarify that the vast majority of institutions of higher education do not have large endowments to rely upon. Would you agree that even if we could require schools to use more of their endowments for tuition reduction than they already do, it would become nowhere—it would come nowhere close to eliminating the need for important Federal student aid, aid programs like the Pell Grants, like Supplemental Education Opportunity Grants, and subsidized student loans?

Mr. HARTLE. Thank you for the question, sir.

You are absolutely right. The vast majority—as Mary Francis McCourt has indicated, the vast majority of college and university funds are restricted. They are given to institutions by donors for purposes that the donors specify. Many times, the donors will want to give the money to something—to the institution and the institution will say, “We might rather have it for this,” and the donor will say, “I will give it to you for what I want”——

Mr. CROWLEY. Only for this.

Mr. HARTLE [continuing]. “Or nothing.”

Mr. CROWLEY. Right.

Mr. HARTLE. Institutions cannot simply decide to take money that is given to them for one purpose and to spend it for another purpose without violating the law. We have counted in the last 10 years—excuse me—6 legal cases where donors later sued institutions because the donors felt the institutions had not been honoring donor intent.

Mr. CROWLEY. Very interesting.

Mr. HARTLE. Most universities do not have large endowments. The average endowment—sorry—the median endowment for a public university is \$26 million. For a private university, it is about the same level. Obviously, there are a small number of universities that have very large endowments.

And I would actually respectfully disagree with my friend Dr. Vedder about the value of endowments and institutional quality. *The Times of London*, an independent news organization, ranks the world's best universities. Seventeen of the world's top 25 universities are American. All of them have significant endowments. These endowments enable them to hire the faculty and staff they need. It allows them to conduct the research that they believe is in the Nation's interest. They can get the equipment and facilities they want and they can allow any student to enroll without having to worry about the financial consequences.

Money helps build great universities and delivers opportunities and I think that the ranking of *The Times of London* and the fact that the American universities that are on that list overwhelmingly have large endowments tells us something, which is that if you have a large endowment, you can build a great university. It is not automatic, but it certainly helps.

Mr. CROWLEY. Thank you.

I was intrigued by Mr. Rangel's questioning. Really, it was right to the point. If we think that this is not a national issue, this is a State's rights issue; we really have to reexamine what we are doing here. The reality is we can't expect that States like—and he mentioned Mississippi, there are others, can invest in the State system in the way in which New York and California maybe can or without the assistance from the Federal Government is really not going in the right direction.

And, again, I hope my colleagues on the other side will take a look at proposals that can truly make college more affordable rather than seeking to cut back on Federal student aid, as we have seen in numerous other Republican proposals.

And, Mr. Chairman, I look forward to working with you on finding ways not only to make college more affordable to you and your family, but to all Americans who want to see their children succeed. I think that is important. It is not just about us. It is about what we can do for the American people and I think it is critical.

Right now is—I mentioned—one last point I'll mention to you if, Mr. Chairman, you will forgive.

Before the Pope came, I had the opportunity to sit down with some of my colleagues with the Conference of Catholic Bishops. I noticed that some of the sharpest tuition increases we have been seeing are at what are known as traditional Catholic colleges. I think there is more responsibility, not only to the Catholic Church but on all of us, to have opportunity for our children to attend private or public schools and to have the assistance in help they need to make it affordable to everyone and not everyone because the economic situation is cast aside or put out of the system because of what their parents did or didn't do for a living.

And with that, Mr. Chairman, I will yield back.

Chairman ROSKAM. Thank you.

I think, just for the record, it is important to note nobody is talking about eliminating Pell Grants. The notion that this is just a State's rights issue is something that is just not persuasive. We have a national Tax Code, national tax implications. So the reason that we are talking about this——

Mr. CROWLEY. Mr. Chairman, would you yield briefly just for a moment——

Chairman ROSKAM. Yes.

Mr. CROWLEY [continuing]. On that?

On that point, there was a question to Mr. Lucca about the impact of Federal subsidies and what impact that has on the increase of tuition at private institutions——

Chairman ROSKAM. Fair enough.

Mr. CROWLEY [continuing]. And that is the point I was making, but I——

Chairman ROSKAM. Yes.

Mr. CROWLEY [continuing]. Think the opposite—you have to suggest the opposite. What impact would cutting it have and that was the point I was suggesting.

Chairman ROSKAM. Fair enough.

So nobody is talking about eliminating Pell Grants. That was your word earlier, but I take your point. If by hosting this hearing somebody is going to pull out the "Peter Roskam three-point plan to save higher education," it is that it is going to be a slow train coming. We have a lot of work to do.

So getting toward that work, I recognize the gentleman from Missouri, Mr. Smith.

Mr. SMITH. Thank you, Mr. Chairman. Thank you for holding this hearing on a quite important issue.

Being the youngest Member of the House Ways and Means Committee and one of the youngest Members of Congress, the rising cost of tuition isn't foreign to me. I get it. In fact, I am still paying my student loans as a Member of Congress. The cost of tuition is rising faster than the cost of inflation. We all know that. It is increasing beyond the reach of lower income Americans and middle-class Americans. We know that. This is a huge problem.

The real question is, how can we help stop the rising costs and make college affordable again? That is a true problem.

When I started at the University of Missouri in Columbia not too many years ago, the required cost of tuition and fees was \$4,280. Currently, it is \$9,433. After adjusting for inflation, that still represents more than a 66 percent increase, 66 percent increase. I wish mutual funds did that well. Universities argue that fluctuating State funding is the biggest factor in tuition increases. But has State funding decreased by 66 percent in the State of Missouri? Being a former State legislator, I know it hasn't.

That being said, the University of Missouri is an example of a good school that has decreased real cost per student. They have lowered actual operating expenses per degrees awarded and are beating the national trend, while increasing degrees awarded. Their tuition is less than the national average, but students still have an average debt of over \$35,000 a year.

We are here in the Ways and Means Committee because of our jurisdiction over tax policy. So I have to highlight the work of col-

leges across the Nation in a bill that I introduced in July, the Tax Relief for Working Students Act. Currently, students earning at work colleges, like College of the Ozarks in Branson, Missouri, are taxed as income, not as tax-free scholarships by the IRS. That is unacceptable.

My bill would reward hard-working students by reducing taxes on those students in order to make it easier for them to earn the scholarships they need to pay for their college. It is just one small piece to encourage the hard work of students at these unique institutions, but other issues must be addressed. After all, taxpayers and students pay a lot of money to colleges and universities, but are we getting proportionate results? Colleges and universities have a tax exemption because we all agree that education is valuable and important, but, as the Federal Government, we need to be sure that this foregone tax revenue is delivering results.

Ms. McCourt, what are some areas that you see where public institutions can be better stewards of taxpayer dollars while still fulfilling their mission of educating future generations?

Ms. MCCOURT. Well, actually, the average debt at University of Missouri surprises me. It is quite high. So I am not sure what is going on at the university that is driving it that high, its undergraduate, graduate. At Indiana University, it is about \$23,000.

Mr. SMITH. I said the average debt—

Ms. MCCOURT. Yes.

Mr. SMITH [continuing]. Of all students is \$35,000.

Ms. MCCOURT. Yes. Okay. So graduate student debt—

Mr. SMITH. And the University of Missouri is lower than that. So—

Ms. MCCOURT. Oh, okay.

Mr. SMITH [continuing]. I want to make sure you are—

Ms. MCCOURT. Oh, okay.

Mr. SMITH [continuing]. Correct on that.

Ms. MCCOURT. I was going to say and all students—so graduate students, that is a different issue and that is where a lot of debt is.

Indiana University is doing a lot—I want to make sure I have heard your question appropriately. We have done a heck of a lot with operational efficiencies driving costs down, everything we can do almost on the cost side of the equation. When you look below salaries and wages and benefits, financial aid is the next line down. So I am always being careful what you ask for because cutting budgets further, we have reduced administrative headcount over the last decade. We have kept salary increases at about 2 percent a year, some years none.

So when we think about the compounding issue on the American economy, one thing we haven't talked about today that I think is a very important issue is the issue—and this goes back to the metrics and benchmarks that we should all be held accountable to—of completion. You know, we have seen completion moving from a 4-year completion rate—we talk about 5- and 6-year completion. The fastest way to reduce debt is to graduate, and, you know, so I think there is accountability on all sides. There is accountability on the institutions of higher education and on the recipients of these grants and aid.

I think there is something there to——

Mr. SMITH. In regards to costs, to——

Ms. MCCOURT. Yes?

Mr. SMITH [continuing]. Help lower the cost, what has your university seen in regards to health care?

Ms. MCCOURT. Our university—when I came—so I have been there 10 years. When I started modeling healthcare costs, we were going to see healthcare costs double in the next, like, 5 or 6 years in that first model. We have now taken that down. We have a massive wellness initiative, but health care is a big cost underneath—after compensation, that is the next one down.

As I have the opportunity, I also want to draw attention to the first slide that was up. When we talk about the rising cost of health care, we need to be careful because most of the—you know, when the Bureau of Labor Statistics looks at healthcare costs, they don't look at sticker price. They are looking at net price, but when we look at higher education price, we are looking at sticker. We have to focus on net price because net price tells you a very different story.

Chairman ROSKAM. It tells you a different story, but it doesn't tell you a different trend and we can talk more about that.

Ms. MCCOURT. Yes. Yes, I would love to circle back with you on that.

Chairman ROSKAM. Okay. Thank you.

Mr. Meehan.

Mr. MEEHAN. Thank you, Mr. Chairman.

Mr. Vedder, I hesitate to do this, but—and I know it was even a moment of rancor, but in the context of doing that, you made a comparison between rankers and rapists. As a former prosecutor, there is nothing in any context which is jovial about that issue and I hope that you will retract your statement.

Notwithstanding that, and I am sorry that I raised the issue, but I thought I had to, Ms. McCourt, you just raised a very, very important issue which relates to the ability of students to graduate on time. What is the impact of students not graduating on time and despite all of the infusion of dollars, are we actually doing better at graduation rates?

Ms. MCCOURT. The impact is more debt, if they are financing their education with debt, and lost earnings.

Mr. MEEHAN. This is particularly troubling to me because when you really go through the statistics, when you start to see who is impacted the most, and oftentimes we hear about this, poor students are taking on more and greater burdens with loans, and as a result, they are paying—they are increasing debt for poor students and their families. The average working family in the blue collar districts that I represent has a \$55,000 salary and, if they have two children in school, their after-tax income, virtually 100 percent of it would be paid toward college education.

Ms. MCCOURT. If they are making \$55,000, most institutions of higher education would be offering them significant aid.

Mr. MEEHAN. You expect that they would be——

Ms. MCCOURT. Absolutely.

Mr. MEEHAN [continuing]. Offering them significant aid.

Ms. MCCOURT. Absolutely.

Mr. MEEHAN. If I might, and this is a question just of accountability, is public education a public service? Those who—is it a public service? If you are at a public college, is that a public service?

Ms. MCCOURT. I think we owe it to our younger population to educate them. When we talk about the issue of the U.S. economy and our ability to compete, you know, on into the future, yes, I think we owe it to our—

Mr. MEEHAN. Well, are we talking—let me ask it another way.

We talk about accountability for institutions and I realize that these are difficult—and in some ways, it may even be symbolic, but should a president of a college, notwithstanding the complexities, be making more than the president of the United States?

Ms. MCCOURT. I am going to go back to the issue of running a very large—

Mr. MEEHAN. Yes or no?

Ms. MCCOURT [continuing]. Complex—I am going to—the market of supply and demand and labor and getting good talent to run these institutions of higher education, I think the president—

Mr. MEEHAN. But you don't think we get very good people to be superintendents of high schools and very good people to be school teachers in public school systems and you don't think with the prestige associated with being at a public institution of major—that we wouldn't be able still to attract the highest quality person as the president of a major university if they were being paid—

Ms. MCCOURT. I think if—

Mr. MEEHAN [continuing]. The same salary as the Governor?

Ms. MCCOURT [continuing]. I think if we don't pay people appropriately, you will not be able to attract the talent you need at these very large, complex institutions.

Mr. MEEHAN. Let me ask a question about accountability for anybody here.

I hear two things when I go and talk to my students. One is their aspirations, and I ask this question very specifically, and the second is what concerns you the most and invariably they say, "How are my parents going to pay for college education?" So it is affecting every family across America, but one of the bigger concerns I get is when I go to employers and they say to me that they can't find people who are adequately trained to fill the jobs that they have.

Where is there a measure of accountability and this is for anyone that looks at it and says if we cannot fill the available jobs here in the United States with college graduates—and I say this as a liberal arts graduate, a classics major like my colleague here, who finds great value in that kind of an education, but notwithstanding, we are not educating for the jobs of today and they are going unfilled at great cost to us?

Where is the accountability there? Why should we not hold institutions responsible for their failure to meet that?

And I open it to anybody who may have—

Mr. VEDDER. Mr. Meehan, I apologize for my earlier remark.

With respect to that question, we don't have a good match between what people do in college and what the labor market wants and some people have suggested that one way to sort of incentivize colleges to get a little better on this is to have colleges have skin

in the game. Now, that can be—take different forms. One way is with respect to defaults on student loans and all, that maybe the colleges ought to pay back some of that rather than the students themselves. I think that is something that Congress maybe should start looking into.

And it is interesting, by the way, that I have heard people on both sides of the aisle, I won't name names, but from highly progressive liberal Democrats to fairly conservative Republicans, saying the same thing. So this might be an area where there might be some bipartisan possibilities.

Mr. MEEHAN. Thank you, Mr. Vedder.

Mr. Chairman, I yield back.

Chairman ROSKAM. Ms. Black.

Ms. BLACK. Thank you, Mr. Chairman. I appreciate being a part of this Committee. I thank you for allowing me to be here and ask a question.

This is an area that I have great concern about, having served on the Ways and Means Subcommittee on Education and coming out with some ideas of our own, but I want to follow the vein of my colleague, my colleague that was just questioning, Mr. Meehan, about outcomes and about how we get to know about those outcomes so that as we look at these costs, which has been established are really high costs, rising costs, that students and their families would be able to make those decisions that are necessary in order to be able to decide what can I afford and what can I expect as an outcome if I choose this particular university or this setting.

Last month, the Department of Education and the IRS published a new college scorecard database to help students and their families make more informed decisions about higher education. The scorecard provides information about the student outcomes from individual schools, including information about post-college earnings and debt levels.

Mr. Vedder, what are your thoughts about this scorecard? Is this a scorecard that is something that the students and their families can really count on in helping them to make that best decision?

Mr. VEDDER. Well, I think the scorecard is a step forward. There is a huge information problem in higher education. I have been saying this all throughout this hearing. And the scorecard does provide some information that was previously not available, for example, earnings data on post-graduates.

There are some deficiencies in that scorecard. We don't—first of all, there are a few schools that are not even included in the scorecard. I can name—you know, Hillsdale College would be one. Grove City College would be two. Christian College would be three. I could name several universities.

Ms. BLACK. Well, why are they not included in it?

Mr. VEDDER. Well, you will have to ask them, but I think it relates to the fact that they do not participate in the—they don't participate in Federal student aid programs.

Ms. BLACK. Oh, okay, the Federal student aid programs. Okay. That is—

Mr. VEDDER. And, although Hillsdale also claims that they refuse to provide race information, they don't as a matter of prin-

ciple. I read this in *The Wall Street Journal*. So there are deficiencies there.

Ms. BLACK. Okay.

Mr. VEDDER. It would be nice if we had more information on earnings by major, earnings by—in a variety of other contexts other than just one earnings measure. It is—as I say, it is a start, but we are way, way, way behind where we should be in this area.

Ms. BLACK. So, in your opinion, and the opinion of others on the panel, what do we need to do to force this to occur because I believe there isn't enough information out there to be able to use good data to drive those decisions so that when you are spending \$23,000 a year, which is a huge amount of money for education, that you could say at the end of the day, that money was well spent because I am going to get this job or I am going to be able to move up in whatever my job is?

What else do we have to do? What else should we be looking to do? Mr. Vedder.

Mr. VEDDER. Well, let me respond. I think—

Ms. BLACK [continuing]. You want to start and then—

Mr. VEDDER [continuing]. I see Mr. Hartle wants—

Ms. BLACK [continuing]. Mr. Hartle, yes.

Mr. VEDDER [continuing]. To respond as well. I think we could—one thing that has been suggested is that we actually have some sort of—something like the collegiate learning assessment tests that could be administered at the freshman and senior years nationwide or something so we can measure value-added during college of what students learn. We do it certainly at the K through 12 level. We could do it on a—and I am not proposing a huge, highly intrusive amount of testing, but we could do a little bit at that national level.

The Spellings Commission a decade ago, which I was a member of, made recommendations along—or in that direction. Nothing was done. Colleges don't want to be compared with one another. They don't like—it is sometimes embarrassing. Two comparable schools are different in some ways. They don't want the information out. I think we could force more information to be provided along those lines.

We need better information on what happens to students after they graduate than we are getting now.

Ms. BLACK. Mr. Hartle, I have exactly 27 seconds, so if you could just quickly tell us your thoughts.

Mr. HARTLE. I would be happy to chat with you following the hearing if that would be helpful, but I think to answer your point about Hillsdale, one of the limitations of the Department of Education's scorecard data is it is only for students who received financial aid. So schools like Hillsdale who do not participate in the Federal student aid program don't have anybody in the database. Only a fair number of students are excluded, so some schools, the numbers are based on 10, 15, 20 percent of the students rather than the entirety of the student body.

The fundamental challenge you face at the Federal level is the Federal Government does not have good data to do what they want to do. The Department of Education can only rate schools on four

pieces of information: retention, graduation, student loan defaults, and now student loan repayments. Not all of those are accurate.

Fundamentally, the question for the Federal Government is whether they want to create a database that would enable them to very accurately compare information by tracking individual students.

Ms. BLACK. Thank you. And I know my time has expired. I do think this is an area that we really do need to take a look at. Thank you very much.

Chairman ROSKAM. Thank you.

Mr. Reed.

Mr. REED. Thank you, Mr. Chairman, and as a former Member of this Subcommittee, I so appreciate the Chairman holding this panel and having this testimony here today and I wanted to come here today because this is a priority issue to me.

As the youngest of 12 siblings, who was raised by a single mother who firmly believed that education was the key to getting out of poverty, this is something I am very personally interested in taking care of because when I got out of school, my student loan debt was \$110,000. So like my colleague from Missouri, Mr. Smith, it was a major load to carry, and when I go around my district and I talk to these students and I talk to these kids and they tell me they are coming out of undergrad with \$100–200,000 worth of debt, we are doing a disservice to the next generation.

So I come here today having taken a hard look, and many of you on the panel know that I am drafting legislation as we speak, to deal with what I believe is a crisis when it comes to higher educational costs in America and what we are doing to the next generation.

One of our proposed reforms that I am very interested in and that the testimony here got into today is when I looked at the endowments of our largest universities and colleges, the top 90–91 universities and colleges, each having \$1 billion or more of funds in endowments, I realized that those endowments are being held in a tax-free status. Then I realized that donors get a tax deduction for giving these gifts to these institutions. Then I realized when you do the simple math, for example, and to all the reporters out there, if we just change the rules and force this endowment to be a pot of money to be utilized to reduce tuition for our students, we could have a headline that says we propose in the crisis, for the immediate short-term future, that students at these institutions will pay zero dollars for tuition, zero dollars.

Also, Mr. Galle, your testimony touches upon that a little bit in the Harvard Study and let me just do some math. Harvard, \$5.5 billion in returns tax free last year, total tuition charged to its undergrad population, \$360 million, \$100 million is given to Harvard from Federal and State local sources. So when my colleague from New York talks about why is this an issue or why are we even discussing this, I would propose something to you.

In order to keep that tax-free qualification that we are referring to here today, maybe we mandate that the endowments take their earnings, just their earnings, not their principal so we don't get into the sustainability issue that some of you expressed here today, and mandate it goes to tuition relief to the students that are going

there, plus the \$100 million that your institutions get in these high endowment level institutions, that goes to other institutions across America, to the other schools that don't have this size of endowment. That is \$100 million that would be going from Harvard to a different institution to allow those costs to be lowered at those institutions.

Take Yale, \$3 billion return on their endowment, \$291 million of tuition charged to its undergrad population. If you just took 10 percent of that money and gave it to the kids that are going to school there, you wouldn't have to charge one kid a dime to go to that institution. That is addressing this crisis, in my opinion.

Texas, which has the second largest endowment I believe, \$339 million worth of tuition. It is getting a \$3 billion return on its endowment each year tax free. And I am not even talking about what your endowment managers are making off of that return and some of these endowment managers are making \$200–300 million just off of that return on an annual basis. Talk about going after the top 1 percent. This is an opportunity to address this crisis that our kids in America are facing and I would hope my colleagues on the other side would join me in these types of reforms and looking at this resource and saying maybe we can utilize this to address this crisis and go forward.

Mr. Hartle and Ms. McCourt, you actually gave me some information today because the restriction on the gifts to these—from these donors and to your institutions, I think the benefit of being on this Committee—you say the law restricts you? We can change the law. We write the law. That is what we are here for because the donors, if they were then told that, hey, if I have to give money to an institution and I am going to lose my tax deductibility, maybe the conversation you could have with that donor is going to be a little bit different and say, “Do you really want to give us that taxable gift as opposed to a non-taxable or a tax deductible gift that we could do,” if we change the rules so these restrictions are out the door?

So this is an opportunity. I want to work on reforms that are going to say in a headline we propose zero tuition to the kids of the next generation as we go through this crisis of getting college costs under control. To me, this is a great opportunity. This legislation is being finalized and I hope my colleagues on the other side of the aisle would join us in this reform and alleviate this debt burden that we are putting on this next generation of kids like myself when I came out of college with \$110,000 worth of debt.

It is not right. It is wrong. I care about these kids and we are going to make sure these kids get the education that gets them out of poverty to enjoy the opportunity of America.

With that, I yield back.

Chairman ROSKAM. Thank you, Mr. Reed.

You know, I think it is interesting—I have a few questions, but it is interesting if you listen to the nature of the discussion today, there is really nobody that is defending the status quo. There is no voice up here on either side of the aisle that said it is great, just leave it alone. There is no panelist who said, oh, it is great, just leave it alone, which means I think that there is an opportunity for us to be rethinking these things.

So I had some questions that popped up. Ms. McCourt, let us just follow up because we had a little bit of a dialogue that was just intermittent.

Let me recharacterize your testimony as I heard it, particularly as it relates to sticker price. So the sticker price, you said, look, that is one figure that tells part of the story. Let me stipulate a couple of things.

Let us say for the sake of argument that the sticker price tells one story and that the actual price is a different story. The trend, though, is significant. So in my opening statement, I referenced this relationship between healthcare costs—the rise of healthcare costs and the rise of higher education and I said that higher education was increasing twice as fast as health care. So for the sake of argument, let us say that it is just increasing at the rate of health care. Okay.

The rise in health care, I would argue the public is getting a benefit at least. We are living longer. We are living healthier lives. You know, we have devices, we have this, we have that. We have all kinds of things that have changed the quality of life.

And my question is: Can we really say that about higher education?

Going back to Mr. Holding's admonition, is his classics education fundamentally different from his father's or grandfather's or grandmother's or great-grandparent's into perpetuity?

You see the point that there is some value proposition that the healthcare enterprise at least can turn to, and really are students better, faster and smarter with the amount of money that is going into the front end of this?

Ms. MCCOURT. There are several points I want to make. So let me just try to touch on them quickly. But the wage gap has never been wider for those with a college education and those who do not have it. There are many benefits.

There are direct benefits, and then when you think about societal, health, there are all kinds of benefits when you study those with college educations and those without. So I would venture to say, yes, there are extreme benefits.

I would also say that the classics education, maybe the book you are reading is the same, but there are many things that are happening in institutions of higher education that are wrapped around the classics education. There is technology in the classroom. There is technology in the books. There is technology across the campuses. There are career and advising services that have not been there before.

So there are many additive costs, and I am in a classics; I am an economics degree as well so not classics, but liberal arts, and when you think about society and we have talked about, you know, other countries and advances they are making. If we do not think the advances in research and technology, innovation is the way of the future. A lot of that innovation is happening on college campuses.

So, yes, there is a—

Chairman ROSKAM. Okay. So you would make an argument there.

Mr. Hartle.

Mr. HARTLE. Just an observation. Your charge is actually net cost of attendance over time. So it would be tuition and fees, room and board, books and supplies for students who live in university housing, which is only about 15 percent of all students.

Net tuition is \$3,000 for students in public 4-year colleges, \$12,000 for students in private colleges. Obviously, students who do not live in campus housing may well have limited expenses, but yours is showing a total cost of attendance for a specific type.

Chairman ROSKAM. And so your argument is that universities can control part of that, that is, on-campus living, and they cannot control part of it; is that right?

Mr. HARTLE. No, the argument is that for the 85 percent of students who do not live in university housing, they are not facing that as a net price. They are facing something different in many cases.

Chairman ROSKAM. I understand your point.

Let me switch gears a little bit. Ms. McCourt, getting back to you, first of all, I stipulate that Indiana University and Purdue University are doing remarkable things, and this is not false praise. It is really remarkable, and particularly leading the Nation in a lot of these things, and I know that you are inextricably linked to the success there.

You are today here, however, on behalf of a larger organization.

Ms. MCCOURT. Right.

Chairman ROSKAM. And so, you know, they are all with you. So let me ask you this. You were implicitly defending high salaries for—

Ms. MCCOURT. I—

Chairman ROSKAM. You were explicitly defending high salaries—let me make a point—for university presidents, and your thesis was, look, these are big systems, and if you need big systems to be run, you need bright people to run them, and bright people are expensive. And that is not an irrational argument.

Here is the plot trap though with that argument, I think. The comparison was made to the private sector, that is, the for-profit sector. The for-profit sector is only able to deduct \$1 million in salary, you know, publicly traded C corporations. That is it.

Now, what do you think about an excise tax, for example? If the university says this person is so special that we have looked across all the fruited plain, and we think that this is the absolute person that we need to bring in for this.

Is it reasonable then to create a comparison with the private sector because you used the private sector as an analogy?

Ms. MCCOURT. I think you would find so very few people who would meet that criteria it would almost—

Chairman ROSKAM. Really?

Ms. MCCOURT. Yes.

Chairman ROSKAM. Wow, that is amazing to me.

Ms. MCCOURT. Yes.

Chairman ROSKAM. That people would say, “I am unwilling to do it,” and that the universities would be unwilling to pay an excise tax. That is interesting.

Ms. MCCOURT. No, I did not say they would or they would not, but I am thinking right now of the institutions of higher education

across the country, and anyone paid over \$1 million. There are not that many.

Chairman ROSKAM. Well, there are 42.

Ms. MCCOURT. Okay. Forty-two out of all of the employees in institutions of higher—

Chairman ROSKAM. So you would not object to them? You would not object to that?

I mean, I am not trying to trap you. I am trying to understand.

Ms. MCCOURT. Yes, I may not.

Chairman ROSKAM. Okay. Mr. Vedder, what do you think of that, the idea and the comparison to C corporations and so forth?

Mr. VEDDER. Well, I think there ought to be a level playing field. I think the tax treatment of employees working for the private sector and public sector should be the same. Whether the current million dollar rule is the appropriate rule, I have not really studied that or thought much about it.

Chairman ROSKAM. In fairness, neither have I. I am just thinking through the comparison.

Mr. VEDDER. But I cannot see why university presidents would be treated differently, and I have even read many cases where the IRS has gone and said, "Oh, you have not paid taxes on your presidential mansion you are staying in and we are going to make you do that."

And then the boards of trustees say, "Oh, we will pay that for you." You know, it is almost like only little people pay taxes.

And I think economists generally favor level playing fields.

Chairman ROSKAM. Let me ask you, Mr. Vedder. There has been some discussion around restricted contributions, you know, restricted gifts and so forth, and the inherent limitations. Listen. That makes sense. You can understand if you accept a gift that is a donor-directed gift you are bound to use it in the way that the donor would contemplate and direct.

Is there any wisdom to giving it different tax treatment though? In other words, a donation that goes from a donor to a university that is unrestricted, should that be given more favorable tax treatment than a donation that says, "I am restricting you to use it for this particular purpose?"

Could you not make the argument that part of the benefit that the donor receives at the front end is the capacity for direction as opposed to an unrestricted gift which the law would view as a higher good, going back to Ms. Noem's point, and that is, you know, creating more flexibility and so forth?

Does that make any sense?

Mr. VEDDER. It makes sense. It is an intriguing idea. I think there are some administrative issues. I am trying to think of the practicalities of how you define, how you differentiate, but I think it is an interesting idea.

Similarly, as I mentioned in my testimony, there are certain kinds of university donations that are clearly to non-academic purposes. I mean stadium skyboxes, why should some who love their alma mater and want to sit in a fancy skybox get credit for it, why should they get a tax break for that?

I am going to get in trouble. Princeton University built a dorm, particularly with your own staff that went to Princeton. Princeton

University built a dorm that cost \$120 million. Three hundred and fifty kids live in that dorm. That is \$340,000 a bed.

Meg Whitman made a big part of the gift, a major corporate donor. She probably received at least a \$10 million deduction for that, to provide a facility that cost more than a typical resort built by a man who is running for President now, who will remain nameless.

So it seems to me that there is a lot of reason to look into the nature of the gifts, and that may mean to do what you are suggesting. I have not really thought it out fully.

Chairman ROSKAM. Okay. Ms. McCourt, I just want to get your insight, your insights in Indiana versus the experience of my home State in Illinois. So I am a graduate of the University of Illinois down in Champaign. This statistic I find just jarring.

This is Illinois. At public universities in Illinois the number of full-time administrative staff increased 31 percent from 2004 to 2010, with only a 1.8 percent increase in full-time faculty and a 2.3 percent increase in students.

The University of Illinois has one administrative staff member for every 30 students. Does that seem absurd to you like it does to me? And I mean gratuitously absurd.

Ms. MCCOURT. Well, I do not want to comment on that. I can tell you at the university—

Chairman ROSKAM. I would not either.

Ms. MCCOURT [continuing]. The trend is exactly the opposite. Over the past decade we have seen a 14 percent increase in academic staff and a 3 percent increase in administrative staff.

When I take that back to fiscal years 2004 to 2011, and then the years 2011 to 2014, administrative staff has actually gone down 2 percent while academic staff has gone up 3 percent, for a net change of zero.

Chairman ROSKAM. Is that in Indiana?

Ms. MCCOURT. That is Indiana.

Chairman ROSKAM. Okay.

Ms. MCCOURT. I mean head count, but to your earlier point—

Chairman ROSKAM. You have a good point because you can argue in the alternative. When you want to put on your Indiana cloak you do, and then when you have the whole crowd in the room—

Ms. MCCOURT. But to your earlier point, this is why we need—

Chairman ROSKAM. Hang on.

Ms. MCCOURT [continuing]. This is why we need to bring business people to higher education, to focus on these metrics.

Chairman ROSKAM. Is that true though. Are those statistics nationwide statistics or are those Indiana?

Ms. MCCOURT. I think you are seeing a very large trend, and we are now approaching this bubble of people retiring out of higher education. There is just a lot of retirements.

Chairman ROSKAM. Okay.

Ms. MCCOURT. And so as they retire, they are not getting hired back on the administrative side.

Chairman ROSKAM. Okay. Put on your cloak of the organization now.

Ms. MCCOURT. Yes.

Chairman ROSKAM. You are out of the safe zone of Indiana.

Ms. MCCOURT. Yes.

Chairman ROSKAM. Now you have the whole team.

Ms. MCCOURT. Yes.

Chairman ROSKAM. In 2012, Sterling Partners and Bain & Company wrote a report, which I would like to enter into the record with no objection.

[The submission of The Honorable Peter Roskam follows:]



The financially sustainable university

A focused strategy can help colleges and universities reinvent their industry and stop spending beyond their means

By Jeff Denneen and Tom Dretler

**STERLING
PARTNERS**

BAIN & COMPANY 

Jeff Denneen leads the Americas Higher Education practice for Bain & Company and is a partner in the Atlanta office. Tom Dretler is an executive in residence with Sterling Partners and is board chair and co-founder of the Alliance for Business Leadership.

The authors would like to thank Jeff Selingo for his contributions to the report. Jeff Selingo frequently writes about higher education and is the author of the forthcoming book *College (Un)Bound: The Future of Higher Education and What It Means for Students*, due from Amazon Publishing/New Harvest in spring 2013.

Few industries in the United States have achieved unquestioned global leadership as consistently and effectively as our higher education system. US colleges and universities are the cornerstone of our economic prosperity and the key to realizing the American dream. Thirty years of growth have confirmed the sector's leadership and vibrancy—the result of demographic and economic factors combining to lift higher education even higher.

Despite this success, talk of a higher education “bubble” has reached a fever pitch in the last year. The numbers are very familiar by now: Annual tuition increases several times the rate of inflation have become commonplace. The volume of student loan debt has surpassed \$1 trillion and is now greater than credit card debt. Most college and university presidents, as well as their boards, executive teams and faculty members, are well aware that a host of factors have made innovation and change necessary.

Still, at the majority of institutions, the pace of change is slower than it needs to be. Plenty of hurdles exist, including the belief that things will return to the way they always were. (Note: They won't.) But the biggest obstacle is more fundamental: While leaders might have a sense of what needs to be done, they may not know how to achieve the required degree of change that will allow their institution not just to survive, but also thrive with a focused strategy and a sustainable financial base.

Leading change is challenging in any organization. But in higher education, it's markedly more difficult. If the stakes weren't so high, incremental improvements might be enough. But they aren't, and that's become abundantly clear. Change is needed, and it's needed now. What follows is a road map for college and university presidents and boards of trustees, explaining the scope and depth of the situation, the key actions required and—most important—what it will take to succeed in leading change.

The liquidity crisis facing higher education

If you are the president of a college or university that is not among the elites and does not have an endowment in the billions, chances are cash is becoming increasingly scarce—unless you're among the most innovative.

The reason is simple: Approximately one-third of all colleges and universities have financial statements that are significantly weaker than they were several years ago (see Figure 1).

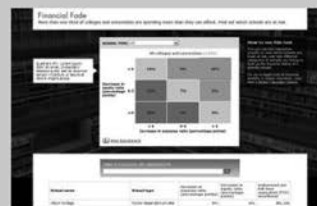
On the balance sheet side, the equity ratio (equity as a percentage of assets) is down—sometimes way down.¹ On the income statement side, the expense ratio (expenses as a percentage of revenue) is significantly up.² And, to make matters worse, endowments have taken a major hit and are not likely to see the type of year-over-year growth they were accustomed to seeing in the decade before the recession.

The translation: Institutions have more liabilities, higher debt service and increasing expense without the revenue or the cash reserves to back them up.

In the past, colleges and universities tackled this problem by passing on additional costs to students and their families, or by getting more support from state and federal sources. Because those parties had the ability and the willingness to pay, they did (see Figure 2). But the recession has left families with stagnant incomes, substantially reduced home equity, smaller nest eggs and anxiety about job security. Regardless of whether or not families are willing to pay, they are no longer able to foot the ever-increasing bill, and state and federal sources can no longer make up the difference (see Figure 3).

Financial fade

Which schools are spending more than they can afford? Explore the data in our interactive graphic at www.thesustainableuniversity.com



The financially sustainable university

Figure 1: Change in equity vs. expense ratios for US colleges and universities

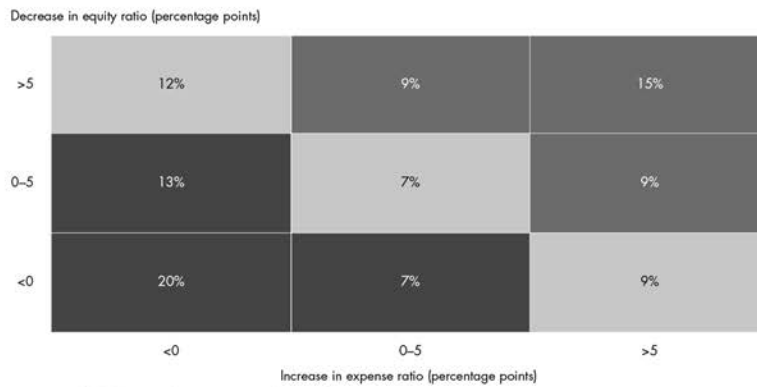


Figure 2: Higher education inflation (2001-2010)

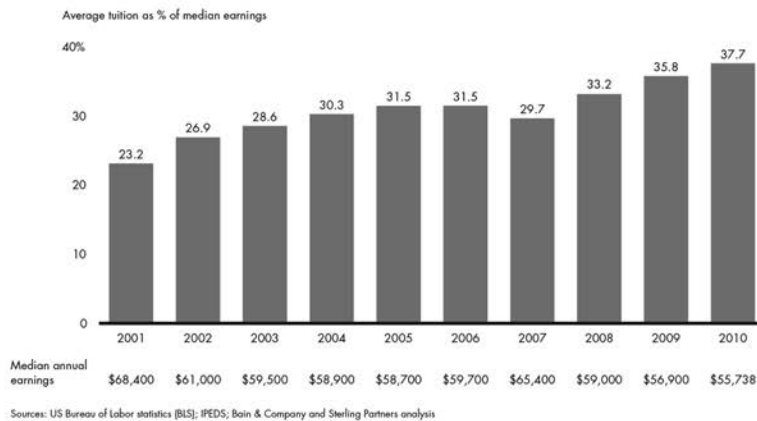
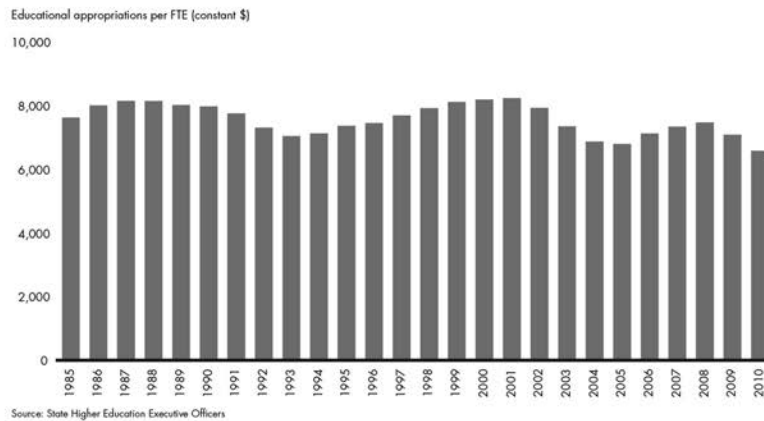


Figure 3: Educational appropriations per FTE, US (fiscal 1985–2010)



Which institutions are at risk?

Presidents who want to give their institution a stress test can simply refer to the list of questions provided in the box on page 7 (*see sidebar*). From a financial perspective, highly selective institutions don't need to worry because they possess pricing power (although they may be concerned that their mission will suffer if they must make compromises to the need-blind admissions policy). Well-endowed institutions or those with strong financial statements through prudent financial management are also fine, because they have ample resources to serve as "shock absorbers."

But what about the others? The data is clear: A growing percentage of our colleges and universities are in real financial trouble. And if the current trends continue, we will see a higher education system that will no longer be able to meet the diverse needs of the US student population in 20 years (*see Figure 4*).

The social and economic implications of that are staggering.

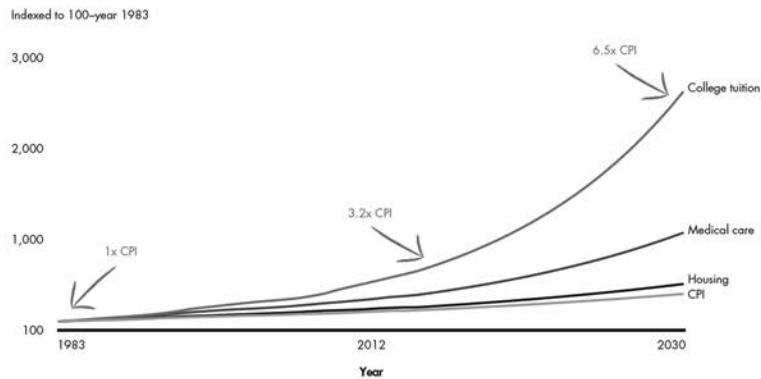
Reversing the "Law of More"

Much of the liquidity crisis facing higher education comes from having succumbed to the "Law of More." Many institutions have operated on the assumption that the more they build, spend, diversify and expand, the more they will persist and prosper. But instead, the opposite has happened: Institutions have become overleveraged. Their long-term debt is increasing at an average rate of approximately 12% per year, and their average annual interest expense is growing at almost twice the rate of their instruction-related expense (*see Figure 5*). In addition to growing debt, administrative and student services costs are growing faster than instructional costs. And fixed costs and overhead consume a growing share of the pie (*see Figure 6*).

This cost growth is at odds with the concept of the experience curve, which holds true in almost every industry. The experience curve indicates that as a company's or an industry's cumulative output goes up, cost per unit of production will go down. A prime example of this is

The financially sustainable university

Figure 4: Projected tuition levels based on historical trends



"Moore's Law," the principle that the number of transistors on a computer chip will double approximately every two years. The semiconductor industry has maintained this pace for decades, leading to consistent increases in computing power and cost reductions for the technology that is at the heart of the digital revolution.

The natural question for higher education, then, is what incremental value is being provided for the incremental cost?

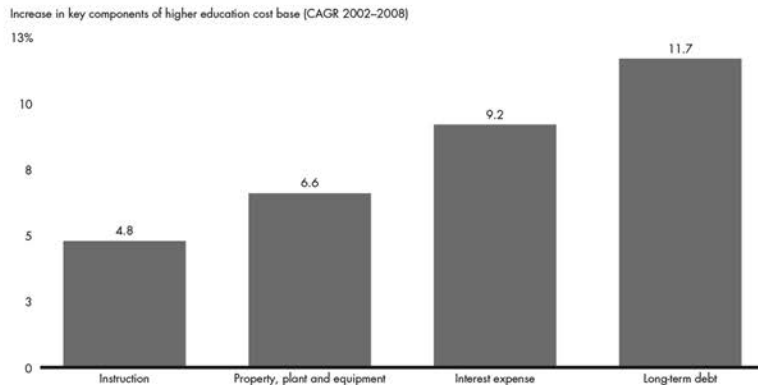
To reverse the Law of More and create a more differentiated and financially sustainable institution, innovative college and university presidents are doing four things:

1. Developing a clear strategy, focused on the core
2. Reducing support and administrative costs
3. Freeing up capital in non-core assets
4. Strategically investing in innovative models

You might think you're doing many of those things through your strategic planning process, but too often that is not the case. Colleges and universities frequently aspire to be the same thing, with a focus on moving up to the next level and gaining greater prestige. It can be far more about "me-too" as opposed to carving out a unique strategic position. As a result, most of the strategic planning that happens in higher education is on the margins and not focused on making the hard decisions that will ultimately lead to success.

Focusing on the core

The healthiest organizations—from Fortune 500 companies to start-ups to academic institutions—operate with a discipline that allows them to stay true to their core business. The core is where high-performing institutions invest the most and generate the greatest returns. It is the area where they are the clearest about the value they add. It is the domain where they are the most differentiated and the place from which they derive their identity. In

Figure 5: Higher education and the “Law of More”

Sources: BLS; IPEDS; Bain & Company and Sterling Partners analysis

short, the core is the strategic anchor for the focused company or the focused university.

In any industry, there are three primary paths to competitive advantage: differentiation, low cost or structural advantage. The trick in pursuing a differentiation strategy is truly understanding your unique core and then focusing resources on it. An implicit part of having a focused strategy is not only defining what you are going to invest in, but also clearly articulating what you are not going to do. If institutions try to pursue too many areas of differentiation, they're likely to invest too broadly and, thus, reduce the return on investment for precious capital.

We recognize that focusing on the core is hard to do, given the history and culture of universities—authority is often diffuse and people don't like to say “no,” especially in the absence of any definition of value. But the worst-case scenario for an institution is to be relatively expensive and completely undifferentiated. Who will pay \$40,000 per year to go to a school that is completely undistinguished on any dimension?

Unfortunately, many institutions seem to be headed down that path. But by focusing on the characteristics that are truly distinctive and channeling resources to them, institutions can positively improve their performance and get on the path to long-term sustainability.

Reducing support and administrative costs

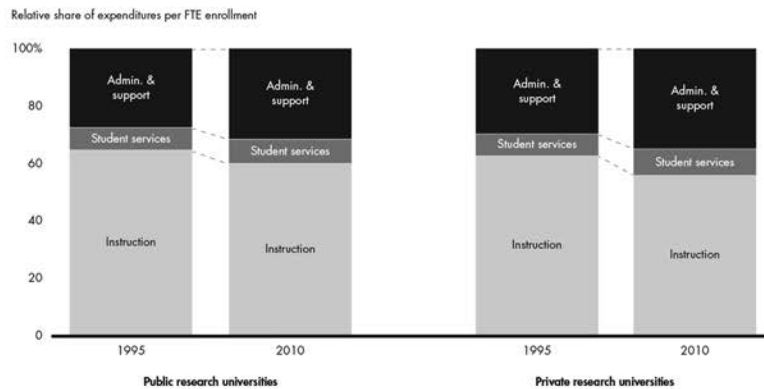
Boards of trustees and presidents need to put their collective foot down on the growth of support and administrative costs. Those costs have grown faster than the cost of instruction across most campuses. In no other industry would overhead costs be allowed to grow at this rate—executives would lose their jobs.

As colleges and universities look to areas where they can make cuts and achieve efficiencies, they should start farthest from the core of teaching and research. Cut from the outside in, and build from the inside out.

Growth in programs and research, increasing faculty and student demands, and increasingly cumbersome compli-

The financially sustainable university

Figure 6: Relative expenditures in US higher education (1995–2010)



ance requirements have all contributed to the growth of administrative costs. The reasons are often very legitimate.

But as new programs are added, old programs often are not curtailed or closed down. The resulting breadth of campus activities creates too much complexity for staff to manage with any efficiencies of scale. Units don't trust one another or the center to provide services, and incentives are not aligned across the campus. These issues ultimately manifest themselves in multiple ways:

- **Fragmentation.** Data center management is a good example of fragmentation on campus. At the University of North Carolina at Chapel Hill (UNC), the central IT group managed fewer than half of the servers on campus in its data center. For the servers located in the colleges, fewer than half were managed by college IT groups—the rest were considered “hidden” at the department or faculty level. Despite the inherent data and security risk of having so many unmanaged servers on campus, faculty members were very skeptical about turning over control to the

university's central IT department. In similar cases, outsourcing data centers would be a good solution. Third-party data centers, whether they are managed or cloud-based, could provide more sophisticated solutions, higher levels of security, greater flexibility in capacity and lower cost than internal solutions—all with greater accountability and less politics.

- **Redundancy.** At the University of California at Berkeley, as on many other campuses, procurement was managed at the department level. There were no product standards, and each department negotiated its own vendor contracts. A sample of purchase orders showed that the same item was being bought for as much as 36% more in some departments than in others. By centralizing and standardizing more of its procurement going forward, Berkeley expects to save more than \$25 million per year.
- **Unneeded hierarchy.** Most campuses have too many middle managers. Before it reorganized, Berkeley had average spans of control (the number of employ-

You might be at risk if....

1. You are not a top-ranked institution

- Your admissions yield has fallen and it's costing you more to attract students
- Median salaries for your graduates have been flat over a number of years
- Your endowment is in the millions not billions, and a large percentage is restricted

2. Your financial statements don't look as good as they used to

- Your debt expense has been increasing far more rapidly than your instruction expense
- Your property, plant and equipment (PP&E) asset is increasing faster than your revenue
- You have seen a decline in net tuition revenue
- Tuition represents an increasingly greater percentage of your revenue
- Your bond rating has gone down
- You are having trouble accessing the same level of government funding

3. You have had to take drastic measures

- You are consistently hiking tuition to the top end of the range
- You have had to lower admissions standards
- You have had to cut back on financial aid
- You have reduced your faculty head count

ees reporting directly to a manager) of around four, compared with more than six for average companies and closer to 10 for best practice companies. Fixing spans and layers, as well as better defining roles, empowers an organization, reduces bureaucracy and significantly boosts productivity.

- **Misaligned incentives.** Unlike the corporate world, where profit and share price (mixed with a pinch of anxiety about pay and job security) ultimately help create alignment, there are fewer mechanisms within a university to improve alignment across the campus. Universities tend to operate as a federation of colleges, and colleges as a federation of departments. Budget models are complex and the flow of funds convoluted. The people who manage budgets often have limited options to influence the entities responsible for consumption and, ultimately, costs (e.g., many campuses don't charge departments for electric power based on consumption). Despite a culture of openness, there is surprisingly little transparency because

data is poor, silos are strong and performance management is virtually nonexistent.

- **Complexity.** Simply put, campuses engage in too many activities that require too broad a skill set to effectively deliver in-house. Take IT application management, for example. Not only does it need to support classroom and research needs across a diverse set of disciplines (history, music, law, engineering, biomedical sciences), it also has to cover functions (finance, HR, research administration, registrar, libraries, student services). If that weren't enough, IT also has to serve industries beyond the core academics, including bookstores, retail food, debit cards, hotels, museums, stadiums, publishing houses, veterinary hospitals and power plants. A single IT group would have a hard time managing all of that well, given the expertise required, leading to either poor service delivery or fragmented, sub-scale and costly delivery.

The financially sustainable university

Outsourcing more of the non-core activities would reduce campus complexity and cost. Third-party providers typically have greater scale capability and skill because the outsourced service is *their* core business, enabling them to deliver the same or better service at a lower cost.

Ultimately, in order to reduce administrative costs without diminishing service—and perhaps even enhancing it—campuses will need to consolidate subscale operations by creating shared services or outsourcing; improve processes by eliminating low-value work and automating more; refresh the organization by streamlining spans and layers and improving performance management; and strengthen controls by updating the budget model, modifying policies and increasing transparency.

Freeing up capital in non-core assets

Another significant opportunity for institutions to strengthen their cash position is to better manage their assets. Whether it is real estate, physical assets or intellectual property, colleges and universities are involved in a number of activities where partnerships with third-party providers would allow for financial relief and improved performance.

Real estate

US colleges and universities collectively have more than \$250 billion worth of real estate assets on their balance sheets. In other real estate-intensive industries, such as lodging, restaurant and healthcare, organizations have consistently found ways to turn a portion of these assets into cash by selling and leasing back, without losing their ability to use the real estate in the same way as before. At some colleges and universities, real estate represents the single largest asset on their balance sheet. The former president of a large land grant institution in the Pacific Northwest expressed one of his biggest frustrations during his tenure: He had been sitting on \$2 billion worth of real estate assets, but he hadn't had the opportunity to use any of it to improve his university's financial situation. Converting even a small portion of an institution's real estate assets to cash could change its strategic trajectory.

Physical assets

Many institutions own other physical assets that could also be converted to cash through sale and leaseback arrangements or outsourced service contracts. In most IT outsourcing deals, for example, the service provider buys the client's IT assets (infrastructure, equipment, facilities and so on) up front and then provides service on a long-term contract.

Hard assets like power plants and cogeneration facilities offer campuses another opportunity to free up capital, as commercial power companies may be interested in acquiring those assets. There is also a growing class of private equity investors looking to infrastructure investments to provide low-risk, stable cash flows to balance out their portfolios. By selling these assets, campuses could free up tens of millions of dollars in capital.

Intellectual property

Many college and university presidents feel that technology transfer offices are the custodians of some of their institution's most underleveraged assets. Indeed, US colleges and universities spend some \$92 billion each year in R&D and realize approximately a \$2 billion annual return on those investments. Conversely, intellectual property companies that manage the patent portfolios of technology giants such as Microsoft typically get returns of several times their clients' original R&D investment. Some of those companies are beginning to look at the higher education sector as an area where they can make a major impact and bring innovative products to market. By partnering with intellectual property companies in the private sector, colleges and universities could tap into a lucrative new source of revenue to strengthen their balance sheets and support other mission-focused organizational activities.

Strategically investing in innovative models

College and university presidents are well aware of the "disruptive innovations" that are changing the landscape within higher education. According to a 2011 survey by the Babson Survey Research Group in collaboration with the College Board, online enrollment grew at a compound

annual growth rate of more than 15% per year between fall 2002 and fall 2010, increasing from less than 10% of all higher education enrollments to just more than 30% during that period. A recent Bain survey of 4,500 students also indicates growing online enrollment: Approximately 45% of respondents had taken an online course.

The rapid growth of online education has changed the game in a number of areas: value proposition (flexibility for students), economics (higher fixed-cost percentage, but lower fixed-cost dollars), marketing and recruiting (increasing reach) and outcomes and assessment (better tracking and measurement). Nearly two-thirds of the college and university leaders at more than 2,500 institutions surveyed by the Babson Survey Research Group said that an online strategy is critical to the long-term success of their institution. Yet surprisingly, less than 50% of responding CEOs had included online programs in their campus strategic plan.

There is no question that the online market is rich with opportunity, but until you have defined your core strategy and identified significant capital to invest in creating academic value, you will not survive in the online arena. For some institutions, rushing into the online space too rapidly to grow enrollment and create new revenue is another me-too strategy. There are already too many entrenched players and new entrants with significant capital in the market for an undifferentiated strategy to succeed.

As online courses enter the market and employers begin to accept “badges” and other credentials (further decreasing demand for traditional degrees), the price students will be willing to pay for undifferentiated brands will continue to fall. While this won’t be a problem for elite institutions like Harvard and MIT, it represents a significant challenge for most colleges and universities.

Leading the change necessary to be successful

Creating change on campus is harder than creating change in a corporate setting. In the corporate ecosystem, power resides largely with the executive team and cascades down. In academia, power usually emanates from the faculty and works its way toward the central admin-

istration. The concept of shared governance, combined with academic autonomy and tenure, leads to an organization where broad change cannot be mandated. Instead, change on a large scale can only be achieved by working with the faculty to build a compelling case and a clear path forward—one that supports the mission of the institution, but copes effectively with fiscal constraints.

Based on the many conversations we’ve had with campus leaders, it’s clear that they generally know what to do, but really struggle with how to do it. To implement a strategy that allows the organization to focus on the core, reduce costs, outsource and monetize assets, and develop online and lower-cost programs, institutional leaders need to bring key stakeholders on board and be clear about roles and accountability.

Bringing key stakeholders on board

One university chancellor told us, “20% are always going to be on board with me and 20% are always going to oppose, regardless of what the change is. The trick is getting the 60% in the middle to first engage and then buy into the change.”

By nature, faculty members tend to have a low tolerance for business administration and change that disrupts their routines. But most faculty members are also evidence-based decision makers who care deeply about the educational mission of the institution they serve, and this is an area where the president and the faculty can find common ground. There are a few truths that may or may not be self-evident to faculty, but that the president should have ample evidence to support. These truths are 1) there is no status quo; 2) effective change needs to be institution-wide; and 3) budget doesn’t always correlate with value.

There is no status quo

Too often, stakeholders believe that the current cash crunch and need for change is a temporary phenomenon that will subside as the economy continues to improve. But those who see things this way probably haven’t been exposed to the data presented here and in other reports that show convincingly that this time is different. Faculty

The financially sustainable university

and other key stakeholders must be shown clear and compelling facts to disprove the “return to the status quo” notion and to clarify the corresponding negative implications and consequences of inaction.

Change needs to be institution-wide

The magnitude of the challenges being addressed is too great and the organization is too complex for changes to be restricted to certain corners of the campus. Scale matters when you are trying to minimize the cost of administrative functions, and few departments or colleges on a campus have enough scale to achieve real benefits. The support of key stakeholders must be elicited across the organization.

At UNC, the central facilities administration spearheaded a clear example of what can be achieved by working together. The project’s goal was to improve classroom utilization in order to accommodate a growing student body without the need to build new buildings or renovate old ones. Based on an analysis of classroom utilization, the current space could meet anticipated demand, with a higher degree of coordination among the departments, the faculty and central administration. Many classrooms on campus had been scheduled and managed at the department level in nonstandard blocks, and some faculty had been starting their classes on the half-hour on days when the format for other classes started on the hour—effectively taking two time slots for a single class. The administration offered an inducement: In exchange for standardizing class schedules and allowing nondepartmental usage of their classrooms, the administration would pay for technology upgrades. It was a win-win situation: The cost of the additional technology was significantly lower than the cost of building new classrooms, and the departments got upgrades they couldn’t have funded from their own budgets. Beyond capital savings, the teamwork and standardization saved the university \$800,000 and gave it more flexibility in negotiating its overhead rate with federal grant-making agencies.

In other cases, it may be necessary to apply a set of consequences in order to effect change. Given the scarcity of resources and corresponding competition for those

resources, discretionary budget allocations are typically the most effective tool. At one university, the provost provided two budget alternatives to each dean and supervisor. The first was to move forward with the changes suggested by the administration’s “transformation team.” The second offered a flat cut to all units if they did not want to participate in the transformation program. The flat cut in the second alternative was significantly higher than the savings that would be achieved by participating in the transformation. The logic behind this was simple: If any unit abstained, savings would go down for everyone. But by working together across the institution, more could be achieved with less pain.

Budget does not always correlate with value

But working together across the institution does not mean that all campus activities have equal value. Part of a president’s vision for change will need to address where the institution will place priorities that are consistent with its mission and differentiated strategy. For example, in an organization that plans to reduce overall costs, it’s quite possible that some departmental budgets will increase, while less strategic ones will be cut more significantly.

On the administrative side, budget cuts are always perceived as service cuts. Given the way services have been delivered—fragmented and subscale—that’s probably true. But going for greater cost efficiency does not necessarily mean that effectiveness has to decline. Poor operations take longer to perform the same task, require more people to get the work done and tend to have significant quality issues, leading to rework and customer frustration. By building scale operations with the right expertise, process and tools, campuses can reduce cost while actually improving service levels.

On the academic side, given how difficult it is to define and measure value, the underlying rationale supporting academic budgets is rarely called into question. In the normal budgeting process, all departments typically receive what they were awarded the year before, plus a small increase for inflation. This is how one department at a world-class university ended up with a faculty-to-student ratio of greater than five to one, including majors and doctoral students.

Given the concentration of power and autonomy in the individual departments, the tendency within many colleges and universities is simply to assume that all departments should cut equally from their budgets and return those funds to central administration. While this approach is politically defensible as being “fair” and leaves autonomy with the units for deciding how to achieve savings, it is not particularly strategic and creates distorted incentives for managers. In this model, highly effective managers who run lean operations are forced to cut muscle while less effective managers simply trim fat. This leads to a culture where people unnecessarily hoard resources so that they have something to give back when asked.

Another example of budget versus value can be found by looking at Cornell University’s decision to consolidate five different economics departments, which had been spread across multiple schools within the university. All departments were well regarded, but some were stronger than others. When the decision was made to create one top-ranked economics department, some of those departments were essentially eliminated, while others were fortified in the transition. This change enabled Cornell to further its mission and to better serve its students, while also producing significant overall cost savings.

Being clear about roles and accountability

One of the biggest challenges in academia is the lack of alignment and trust that frequently permeates campus environments. There is a perception that departments and units can’t effectively collaborate because they don’t understand one another’s objectives, priorities and needs. The mistrust is compounded by a sense that outcomes aren’t measured appropriately, which leads to a lack of confidence in other departments. All of this contributes to academic units desiring independence and adds to the level of difficulty in driving coordinated institutional change. But this can be corrected by taking needed steps to clarify roles and create a culture of functional and individual accountability.

Role clarity

Several years ago, at one major research university, a plan that made the organization more efficient and saved it money was put in place. Then it was undone. Countless hours and millions of dollars were lost due to a lack of clarity about roles and responsibilities.

For some time, multiple departments at the university had been managing their own unique contract with the same learning management system (LMS) vendor. Each unit had an independent software license, a different software update version, its own server to run the application and an independent employee to manage the system. It was fragmented, redundant and inefficient, but it allowed for independence. Then as part of a campus change initiative, all the departments agreed to have the central IT office manage a single university-wide contract with the vendor. As part of the move, the central office renegotiated a single license, put all units on the same software version, had them share server space and gave a single employee the task of managing the system. The result was significant savings for the university and better operability.

But then things broke down. What hadn’t been made clear during the change was who had ultimate decision-making authority over classroom technology within individual departments. Approximately one year after the change, when central IT informed the departments that the university would be switching LMS vendors, the departments were irate. Feeling that it wasn’t central IT’s call, the departments demanded their individual contracts back—and got them. The savings were erased and trust was eroded. However, if at the outset it had been established which party was being given decision rights over vendor selection, the collaboration would have been much more likely to succeed.

Accountability

While faculty members have incredibly high standards around teaching, research and publishing, which are reinforced through peer review, grading and win rates on grants, they tend not to apply those standards and

The financially sustainable university

rigor to the administration in their own departments. Although many of them are quick to point out the flaws of central service providers, they do not recognize the same shortcomings within their own units.

Creating functional accountability is the best solution to breaking down issues of alignment and trust so that institution-wide solutions can be implemented. First, as the LMS example highlighted, it is critical to articulate roles and responsibilities, including decision rights, for each functional unit. Once that is clear, service-level agreements can be negotiated between the functional service provider and the units. These agreements should clearly spell out what level of performance is expected. Finally, service quality dashboards can be created. These dashboards can be broadly published to create transparency about actual operating performance versus agreed-upon goals. This transparency can help overcome suspicion and distrust about how decisions are being made.


Beyond functional accountability is individual accountability. Because of the decentralized nature of colleges and universities, many roles cross functional boundaries. Universities also tend to be culturally averse to providing critical feedback to staff. At one university, of the more than 6,000 performance reviews on file from the prior couple of years, fewer than 10 were rated as not meeting

expectations. Based on subsequent interviews with campus managers, it was clear that there were more than 10 underperformers on campus! Colleges and universities can put more rigor behind individual performance management by developing metrics for evaluation that everyone can understand and apply consistently.

Conclusion

The Law of More needs to be overturned. Universities simply cannot afford to increase costs in nonstrategic areas and take on more debt, if they want to survive. It is imperative that universities become much more focused on creating value from their core. That will require having a clear strategy, streamlined operations, a strong financial foundation, trust and accountability, and a willingness to invest only in innovations that truly create value for the institution.

Higher education in the United States is at a tipping point. In its time of need, the leaders of our colleges and universities have a tremendous opportunity to reshape and reinvent an industry that is directly linked to our economic prosperity and the hopes and dreams of millions.

That time is now. 

¹ Equity ratio = total net assets (assets – liabilities) divided by total assets

² The asset ratio is calculated by dividing net assets by total assets and measures the strength of an organization's balance sheet. Net assets is a term that indicates the remaining assets on an organization's balance sheet after removing liabilities. The expense ratio is calculated by dividing an organization's expenses by its revenues and indicates the financial sustainability of a business. Simply put, an organization's expense ratio is an indication of its ability to cover the expenses endured by cash inflow.

Shared Ambition, True Results

Bain & Company is the management consulting firm that the world's business leaders come to when they want results.

Bain advises clients on strategy, operations, technology, organization, private equity and mergers and acquisitions. We develop practical, customized insights that clients act on and transfer skills that make change stick. Founded in 1973, Bain has 48 offices in 31 countries, and our deep expertise and client roster cross every industry and economic sector. Our clients have outperformed the stock market 4 to 1.

What sets us apart

We believe a consulting firm should be more than an adviser. So we put ourselves in our clients' shoes, selling outcomes, not projects. We align our incentives with our clients' by linking our fees to their results and collaborate to unlock the full potential of their business. Our Results Delivery® process builds our clients' capabilities, and our True North values mean we do the right thing for our clients, people and communities—always.

About Sterling Partners

Sterling Partners is a private equity firm with a distinct point of view on how to build great companies. Founded in 1983, Sterling has invested billions of dollars, guided by the company's stated purpose: INSPIRED GROWTH™, which describes Sterling's approach to buying differentiated businesses and growing them in inspired ways. Sterling focuses on investing growth capital in small and mid-market companies in industries with positive, long-term trends—education, healthcare and business services. Sterling provides valuable support to the management teams of the companies in which the firm invests through a deep and dedicated team of operations and functional experts based in the firm's offices in Chicago, Baltimore and Miami.



For more information, visit www.bain.com

AMSTERDAM • ATLANTA • BANGKOK • BEIJING • BOSTON • BRUSSELS • BUENOS AIRES • CHICAGO • COPENHAGEN • DALLAS • DUBAI • DÜSSELDORF • FRANKFURT
 HELSINKI • HONG KONG • HOUSTON • ISTANBUL • JOHANNESBURG • KUALA LUMPUR • KYIV • LONDON • LOS ANGELES • MADRID • MELBOURNE • MEXICO CITY
 MILAN • MOSCOW • MUMBAI • MUNICH • NEW DELHI • NEW YORK • OSLO • PALO ALTO • PARIS • PERTH • RIO DE JANEIRO • ROME • SAN FRANCISCO • SÃO PAULO
 SEOUL • SHANGHAI • SINGAPORE • STOCKHOLM • SYDNEY • TOKYO • TORONTO • WARSAW • ZÜRICH



Chairman ROSKAM. Administrative costs “have grown faster than the cost of instruction across most campuses. In no other industry would overhead costs be allowed to grow at this rate. Executives would lose their jobs.”

The Department of Education data shows that administrative positions, that is, non-teaching, at colleges and universities grew by 60 percent between 1993 and 2009. That is indefensible, is it not?

Ms. MCCOURT. Well, I think you need to get below how they are defining administration because outside of my cloak of—

Chairman ROSKAM. Non-teaching.

Ms. MCCOURT [continuing]. Indiana University, non-teaching there is much support staff being hired everywhere. There is also staff when we think about the Clery Act and student welfare and emergency preparedness. That is where the hires are going.

I do not see a lot of hires in kind of business-type administration.

Chairman ROSKAM. Okay. However, if that is true, how are you enjoying such success at Indiana University and the rest of the country is failing?

Ms. MCCOURT. So back to the Indiana University side. We are putting a lot of emphasis on operational efficiency and where can we cut costs.

And the other benefit—

Chairman ROSKAM. So my point is it is possible, and you are showing and you are leading—

Ms. MCCOURT. Yes, we are.

Chairman ROSKAM [continuing]. And the rest of the group is like pressing up their nose against the glass looking in, and they are not delivering.

Ms. MCCOURT. In everybody else’s defense, another benefit we have at Indiana University is because it is a seven campus, we are not a system, but there are seven campuses we operate. We can leverage that size, and we can create efficiencies.

Chairman ROSKAM. Come on. That is not a distinction.

Ms. MCCOURT. It is. I mean, I would love to say it is all great and, you know, we have these novel ideas, but that does give us a benefit. You can leverage, you know, seven accounts payable organizations or seven student services.

Chairman ROSKAM. There are many systems across the country. Nice try.

Ms. MCCOURT. Everyone is focused on it.

Chairman ROSKAM. I get it, but your presence here today and your ability to describe what is happening at Indiana University, to which I give you credit and I admire and what we know Governor Daniels is doing at Purdue is something, is the exact reason that there is an incongruity.

What is happening in my home State is lagging compared to what you are doing. I appreciate your willingness to try to advocate on behalf of a larger entity that you are bound to try to do, and you are doing a good job. The challenge is it is a really hard case to make, and your presence here is the irony that it is possible.

We have been joined by Mr. Dold, whom we will go to quickly, and then we will wind it up.

Mr. DOLD. Thank you, Mr. Chairman.

Again, I want to thank you for holding this hearing on what is an incredibly important topic.

So the Chairman and I actually come from the same State, and I am alarmed at the rate at which the number of administrators is increasing; 31 percent over 6 years for administration to me as a small businessowner seems outrageous.

I have to tell you when I am out talking to people each and every day that are having the kitchen table conversations with their family, the thing that they are concerned about most besides the rising cost of fuel, is the cost of higher education.

We know it is the great equalizer. We know it is the building blocks for everything that we want to do. We want to make sure that people are able to reach their full potential, and frankly, we are going to rely upon you.

Yet, when you look at the cost of higher education over the course of the last several decades, it so far outpaces inflation that one has to take a look and say, "Are we getting better educated today than the folks that graduated before?"

Really, what I want to try to focus on because this is such an important topic is: How do we enable or how do we start getting dual credit? How do we start enabling people to have that leg up when they are coming in so that they are not putting 5 years in instead of 4?

Some of the community colleges, they are spending a lot of their Pell Grant money on remedial education, and we know if they are doing that on remedial education, the chance that they are going to actually graduate and get a certificate out of some of these community colleges diminishes greatly.

I guess one of the questions that I am asking most from you here on the panel is: What would you think about having some of the universities that you represent actually engaged in the student loan process so that we are better aligning the students' outcome and their ability to pay back the universities?

What would you think, Dr. Lucca, about something along those lines? Would that be a change that we might be able to try to better align so that these universities ensure that their college students are coming out and getting good, high-paying jobs?

Mr. LUCCA. My research does not directly speak to that issue, I mean, generally aligning the interests of colleges and students would probably not be a terrible idea, but I have not really researched this.

Mr. DOLD. I would hope it would not be a terrible idea, but I mean, again, we want people aligned. We want people in the row-boat rowing in the same direction.

Dr. Vedder.

Mr. VEDDER. I think, picking up on Dr. Lucca's answer, I do think universities ought to be more aligned with the interests of their students. Their own interests and the students' should be more aligned.

I have been intrigued in my own thinking about doing exactly that. Why are the universities themselves not in the loan business? Why do they not use some of their endowments to invest in their own students?

If we are going to move to a new form of financing of higher education as some have suggested, income share agreements where people sell a share in themselves as it were, equity in themselves rather than debt in themselves so that the risk goes to the investor; why can at least some of the richer schools not be involved in that process?

Why can colleges not have more skin in the game?

Mr. DOLD. Well, I think they need to, to your point.

Mr. VEDDER. So I am sympathetic to your idea.

Mr. DOLD. Mr. Galle, you are over at Georgetown at the Law Center.

Mr. GALLE. Yes.

Mr. DOLD. Do you have great faith that these lawyers or soon to be lawyers coming out under your tutelage are going to do well?

Mr. GALLE. I do. I think one reason to be cautious is essentially in that situation your educator is acting as an insurer, and we know from studying health care usually you want a pretty big pool if you are acting as an insurer. It is not clear that one university level is a big enough pool in order to make a system like that fiscally viable.

I would be interested in Dr. Vedder's research on that front.

You know, another thing to think about when you are thinking about having skin in the game is that as we heard, a lot of States are having less and less skin in the game of the future of people who are being educated in their State, and I think it would be interesting to think about creative ways to get the Federal Government to encourage States to spend more on their students.

If you think about it, for the most part the Federal Government is in the position just of writing checks, and it is hard to get a lot of accountability when you are just the checkwriter. But if you are actually operating the institution, you can control a lot of these levers.

So I think maybe State universities are a good answer for a lot of the affordability problems that people are facing. Maybe there are creative ways to encourage a better balance.

Mr. DOLD. I can tell you it is at a fever pitch, and that most people are terrified about how they are going to be able to afford to send their children to college.

Ms. MCCOURT. I would say colleges and universities have put hundreds of millions of dollars of skin in the game when we look at institutions like Harvard and Yale, which we have talked about several times today. Families that are making under \$65,000 are virtually paying nothing; families that are making up to \$150,000 are paying zero to 10 percent of their income.

Mr. DOLD. Okay. When I go back to Grayslake and talk to a mother of three children, am I going to tell her she is going to pay nothing to send her kids to Harvard?

Ms. MCCOURT. If her kids are going to get into Harvard?

Mr. DOLD. Well, I am asking. That is my point.

Ms. MCCOURT. Her kids are going to get into Harvard and they make—

Mr. DOLD. I cannot go to a mother in Grayslake and say, "Do not worry about college. Harvard is going to pay for it."

Ms. MCCOURT. If the kid gets into Harvard and she makes less than \$65,000, you probably can tell her she is not going to pay anything for her child to attend Harvard.

Mr. DOLD. Okay. So if she's making less than \$65,000 she is going to pay nothing or her children will pay nothing to go to Harvard. How about if we are going to the University of Illinois?

Ms. MCCOURT. The University of Illinois, like all State flagship institutions—I am saying all; most—are putting big dollars on the table, much skin in the game to attract the best and brightest. So if she did not get into Harvard, but anyway—or if you are making less than, I think at Indiana it is about \$65,000 as well, there are hundreds of millions of dollars on the table that institutions are putting up.

Mr. DOLD. I recognize that my time has expired, but let me just say please, in some of our low-income areas, they might not have those things, and if we are looking to try to level the playing field, give them the opportunity. I cannot go to them and say, “By the way, if you just apply, college is going to be free.”

They are looking at the sticker price, and frankly, the sticker price is becoming more and more out of reach where people are throwing up their hands saying, “I do not know how I can.”

Ms. MCCOURT. And that is some of the investments, and when we look at the investments, financial aid, there are a lot of investments in financial aid counselors so that families can come, get on websites and find that they will not be paying those sticker prices.

Mr. DOLD. Thank you, Mr. Chairman.

Chairman ROSKAM. Thank you to all of our witnesses. We are deeply appreciative of the time and energy that you gave us today, and it is not lost on us, your willingness to share your perspectives, and all five of you really added a great deal of insight and value, and I know I speak on behalf of all of my colleagues here, that we are deeply appreciative of your time.

The meeting is adjourned.

[Whereupon, at 12:12 p.m., the Subcommittee was adjourned.]

[Extended Testimony for the Record follows:]



Does Federal Financial Aid Drive Up College Prices?

ACE American
Council on
Education™
Leadership and Advocacy

Donald E. Heller
Dean, College of Education
Michigan State University



Does Federal Financial Aid Drive Up College Prices?

Donald E. Heller
Dean, College of Education
Michigan State University



April 2013

American Council on Education
One Dupont Circle NW
Washington, DC 20036

ACE and the American Council on Education are registered marks of the American Council on Education.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means electronic or mechanical, including photocopying, recording, or by any information storage and retrieval system, without permission in writing from the publisher.

I. Introduction

In 1987, then U.S. secretary of education William Bennett authored an op-ed piece in *The New York Times* titled “Our Greedy Colleges.” In the piece, Bennett complained about a comment made by Benno C. Schmidt Jr., then the president of Yale University (CT), who had blamed Yale’s tuition hike on cutbacks in federal financial aid. Bennett responded by writing, “If anything, increases in financial aid in recent years have enabled colleges and universities blithely to raise their tuitions, confident that Federal loan subsidies would help cushion the increase” (Bennett, 1987, p. A31). The theory behind Bennett’s assertion is relatively simple: The availability of federal loans—particularly subsidized loans offering a below-market interest rate and payment of interest as long as the student is enrolled in school—provides “cover” for colleges to raise their prices, because students can offset a price increase, or at least a portion of that increase, with federal loans.

This one sentence became perhaps the one thing for which Bennett is best known, and it is commonly referred to as the “Bennett Hypothesis.” A Google web search of the terms “Bennett hypothesis,” “tuition,” and “financial aid” provides more than 100,000 results. Over the 25 years since he wrote the op-ed, however, people have misremembered the specifics of both his words and his intent. Bennett was speaking only about the impact of federal subsidized loans on college tuition prices, not about all federal financial aid, let alone all financial aid from all sources. In addition, Bennett was cautious in not implying that federal loan subsidies were the only or even the primary driver of tuition price increases, stating, “Federal student aid policies do not cause college price inflation, but there is little doubt that they help make it possible” (p. A31). While being somewhat cautious, he does leave the reader with the impression that there is some causal linkage between federal subsidized loans and increasing tuition prices.

But over the years, people have reinterpreted the Bennett Hypothesis more broadly, in terms of both the scope and the strength of the relationship between financial aid increases and tuition increases. Numerous stories in the media, as well as monographs, journal articles, book chapters, and policy briefings, describe the Bennett Hypothesis either directly or indirectly. A smaller number of these research studies then proceed to empirically test

the relationship between tuition price increases and loans, as well as state, federal, and institutional grants.

This report examines research that attempts to prove or disprove the Bennett Hypothesis, with a focus primarily on the impact of federal grants and loans on college and university tuition price increases. Section two presents a brief overview of federal student financial aid programs, recent trends in tuition prices, and the economic theory behind financial aid and tuition prices. Section three reviews some of the research that has analyzed the veracity of the Bennett Hypothesis over the years. (The reader is invited to peruse the detailed analyses below, though the results must be presaged by saying that the research on the relationship between federal financial aid and tuition price increases can be described as ambiguous at best.) Section three also describes studies with similar methodologies but contrary findings. The research suffers from limitations in the data used, particularly in the measures of federal aid used as predictors. There are also limitations in the data analysis methodologies employed, including the researchers' inability to fully control for all of the complex factors that go into the decisions that institutions make when determining tuition prices. More details about these issues are presented in this section. The final section summarizes what this body of research tells us about the relationship between federal student aid and tuition prices.

II. An Overview of Federal Financial Aid and Tuition Prices

Federal aid over the years

Federal financial support for college students originated with the Servicemen's Readjustment Act, more commonly known as the GI Bill, passed by Congress and signed into law by President Roosevelt in 1944 (Bennett, 1996; Greenberg, 1997). This legislation provided grants, as well as stipends for living expenses, for military veterans returning from World War II to attend college.

The first federal student loan programs were created as part of the National Defense Education Act of 1958, passed by Congress in response to the launching of the Sputnik satellite by the Soviet Union, among other concerns (Mumper, 1996). This legislation provided federally subsidized loans to undergraduate and graduate students studying in areas deemed to be critical to national defense, including science, engineering, and certain foreign languages.

It was the passage of the Higher Education Act of 1965, however, that first authorized broad-based loan and grant programs. Federal subsidized loans began almost immediately after passage of the act and, beginning with its 1972 reauthorization, federal grants became available. Both the loans and grants were targeted at students with financial need, with the goal of helping to eliminate price barriers for those who were unable to afford to attend college.

Over the ensuing five decades, the federal student financial aid programs, collectively known as the Title IV programs (as they are authorized under Title IV of the Higher Education Act), have grown to the point that today they help millions of students each year to pay for college. Table 1 shows the percentage of undergraduate students receiving federal grants and loans in the 1995–96 and 2007–08 academic years.¹ By the latter year, almost half of all full-time undergraduates were borrowing in the federal student loan programs, and one-third received federal grants.

Table 1: Percentage of undergraduate students receiving federal grants and loans

	1995-96		2007-08	
	All students	Full-time students	All students	Full-time students
Grants	22.2%	30.3%	27.6%	33%
Loans	25.6%	43.6%	34.7%	49.1%

Source: V. Bersudskaya & C. Chang Wei. (2011). *Trends in Student Financing of Undergraduate Education: Selected Years, 1995–96 to 2007–08*.

Since the economic recession that hit the United States in late 2007, federal financial aid has grown even further. The College Board (2011b) reported that in the 2010–11 academic year, 9.1 million students received Pell grants, representing 36 percent of all undergraduates that year, an increase from the 25 percent three years earlier in 2007–08.² The percentage of undergraduate students borrowing did

¹ Federal loans are also provided to graduate and professional students, but as the Bennett Hypothesis has been applied almost exclusively to undergraduate tuition increases, the focus of this report is on undergraduates only.

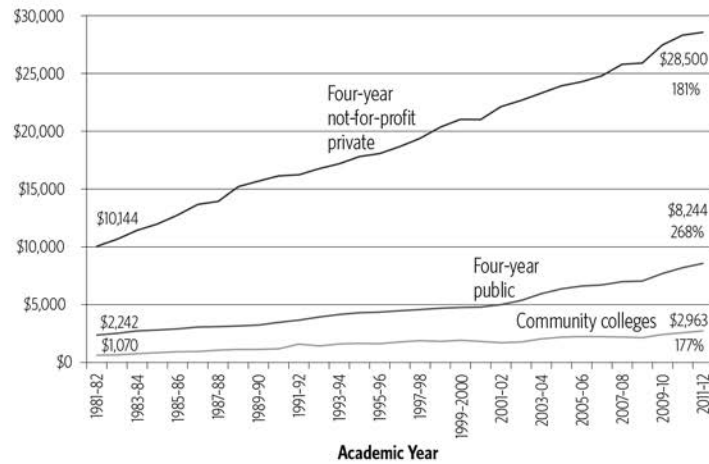
² Analysis of the proportion of undergraduates receiving Pell grants was done by the author. The sources for this analysis were the U.S. Department of Education's 2010–2011 *Federal Pell Grant Program End-of-Year Report* and the 2007 and 2010 Integrated Postsecondary Education Data System (IPEDS) 12-month enrollment surveys.

not change appreciably, however, with 8.7 million undergraduate students receiving federal student loans. They represented 47 percent of all borrowers, a slight decline from the 49.1 percent of students in 2007–08 who borrowed. The large increase in Pell recipients from 2007–08 to 2010–11 was caused by more students meeting the means-testing requirements of the Pell grant program. There were two likely reasons for this: 1) Lower family incomes and asset values, due to the economic downturn, mean more students qualify for grants, and 2) As job prospects worsen and the opportunity cost of college attendance decreases, more students opt to go to college. The increased demand for and receipt of Pell grants has caused the cost of the program to skyrocket, from \$14.7 billion in 2007–08 to \$34.8 billion in 2010–11 (College Board, 2011b).

In summary, participation in the federal Title IV programs has grown over the years, and the growth—particularly in the number of students receiving grants—has been quite rapid since the recession. This has brought increased scrutiny to the program and has only accelerated the concern that the flow of federal funds may provide an incentive for higher education institutions to raise their prices.

The growth in tuition prices

Much has been written over the years about the rise in college tuition prices over the last three decades (Archibald & Feldman, 2011; Clotfelter, 1996; Ehrenberg, 2000; Heller, 2011; Morgenthau & Nayyar, 1996; Mumper & Freeman, 2011). Figure 1 shows the increase in average annual tuition prices in real (constant) dollars over the last three decades in the three major college sectors. (Constant dollars have been adjusted for the impact of inflation, as opposed to current dollars, which are actual dollars paid at a given time.) For example, the price of attending a four-year private, not-for-profit institution increased 181 percent (or almost three times faster than inflation), from an average of \$10,144 in 1981 to \$28,500 in 2011, the latest year for which data were available. Average annual tuition prices at four-year public institutions increased 268 percent, and annual community college tuition prices increased 177 percent.

Figure 1: Changes in annual tuition prices in constant (2011) dollars, 1981 to 2011

Source: College Board. (2011). *Trends in College Pricing: 2011*.

Higher education institutions are complex, often multibillion-dollar institutions, and numerous factors go into the setting of tuition prices at both public and private institutions. However, as stated in the literature cited above, as well as in other sources, there are a number of factors that most analysts agree have helped contribute to these increases, as well as to price increases in almost every other sector of the economy:

- Higher education has always been, and continues to be, a very labor-intensive industry. While technology has been widely embraced in colleges and universities, in most cases the use of technology has enhanced the instructional experience, but not fundamentally changed the educational production function. Much of the labor employed by universities is highly skilled and highly compensated, including benefits packages that are quite generous compared with those received in many other industries.
- Higher education institutions tend to suffer from goal ambiguity, in that their complex missions of teaching, research, and service lack easily identifiable outcomes that can be objectively measured. This absence of clear, measurable goals ham-

pers universities in their attempts to control costs by closing or shrinking marginal programs. Instead, new initiatives tend to get layered on top of old ones, thus adding to costs. Some observers blame the strong role that faculty governance plays in this process, particularly at more elite universities (Clotfelter, 1996; Ehrenberg, 2000).

- States, which historically had been a major source of funding for public colleges and universities, have been disinvesting in public higher education over the last decade. Total state appropriations for higher education decreased 1.8 percent in real dollars between 2001 and 2011, from \$86.2 billion to \$84.6 billion (State Higher Education Executive Officers, 2012). Because enrollments increased during the same time frame, the impact was even greater when measured on a per-student basis. Appropriations per full-time equivalent student decreased 24.4 percent across the nation over the decade, from \$8,316 to \$6,290. In fact, per-student appropriations in 2011 were 21.6 percent below the 1986 level—a quarter century earlier—in real dollars. As institutions receive fewer dollars from states in the form of appropriations, they (along with those in states where the legislature or a state governing board sets tuition rates) naturally turn toward tuition revenues to make up the difference. And most institutions choose not to limit enrollments in the face of constrained appropriations.³

It is important to remember that the average prices shown in Figure 1, and those most often reported in the media and examined by policymakers, are sticker prices—prices before any discounts are applied. The average price that students actually pay, after grants, tax credits, and deductions are factored in, has not grown nearly as fast. Table 2 shows the changes in average annual sticker and net prices between the 1996–97 and 2011–12 academic years for in-state students at four-year public institutions and for all students at four-year private, not-for-profit institutions. Over the 15-year period, the posted tuition sticker price at four-year public and four-year not-for-profit private

³ One exception to this is the state of California, where in the face of state appropriations cuts stemming from the most recent recession (as well as those in the past), all three sectors of public higher education—the University of California system, California State University system, and California Community Colleges—put caps on enrollment (Gardner & Blumenstyk, 2012).

institutions rose, on average, 232 and 52 percent, respectively, beyond inflation. Net prices, however, grew by 30 percent or less in each of the two sectors. While net prices did increase faster than inflation during this period, the rise in net prices was smaller—and in the case of public institutions, much smaller—than the rise in sticker prices.

Table 2: Change in average sticker and annual net tuition prices at four-year public and private, not-for-profit colleges and universities in constant (2011) dollars, 1996 to 2011

	Sticker prices			Net Prices		
	1996-97	2011-12	Change	1996-97	2011-12	Change
Public	\$2,480	\$8,244	232%	\$1,910	\$2,490	30%
Private	\$18,700	\$28,500	52%	\$10,630	\$12,970	22%

Note: Net prices are calculated after all grant aid, tax credits, and tax deductions have been applied.

Source: Author's calculations from College Board (2011), *Trends in College Pricing: 2011*.

Economic theory regarding tuition prices and financial aid

Economists describe two types of price inflation: cost-push and demand-pull inflation (Samuelson, 1976). Cost-push inflation results when the underlying prices of goods rise and there are no suitable substitute goods or services. Demand-pull inflation exists when there is an excess of demand and supply remains largely inelastic, or unresponsive, to the increase in demand.

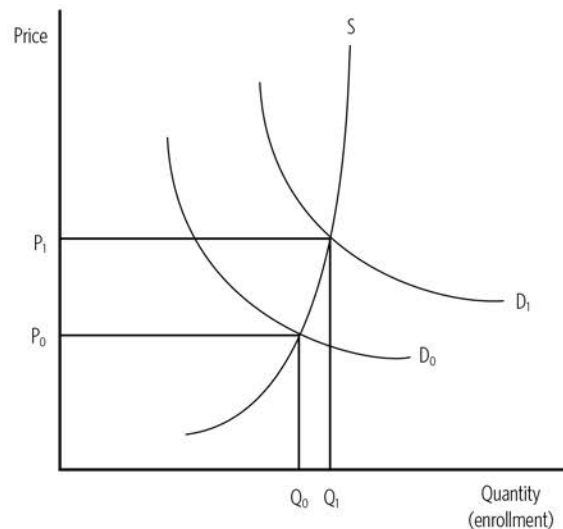
The increase in college and university prices outlined above, much of which was the result of cost-push inflationary pressures, could not have been sustained without an increase in demand for higher education. The increase in the college premium over the last few decades—the additional earnings of college graduates as compared with the earnings of high school graduates—has been well documented (Heller, 2011; Kane & Rouse, 1995; Levy & Murnane, 1992; Murnane, Willett, & Levy, 1995; Murphy & Welch, 1992; Zucker & Dawson, 2001). More and more high school graduates, as well as adult workers with low levels of educational attainment, have noted the college wage premium and have responded by enrolling in postsecondary educational institutions.

The higher education industry in the United States responded to the increased demand by expanding the number of seats available, but not at a rate concomitant with the need. Because higher

education institutions have to be accredited by an agency recognized by the U.S. Department of Education in order to participate in federal financial aid programs (a necessity for most institutions to operate), entry into the market is fairly tightly controlled. Thus, most of this increased supply came from the expansion of existing institutions, rather than the entry of new colleges and universities into the market.⁴

Because supply did not expand as quickly as demand, tuition prices rose more quickly than enrollments. This effect can be seen in Figure 2, which shows the impact on tuition prices and enrollments of the increased demand for higher education.⁵ The curve D_0 represents the demand for higher education prior to the increase in the college wage premium noted earlier, and the curve S represents the supply of higher education. P_0 and Q_0 are the average tuition price and total enrollment, respectively, in the United States, or the equilibrium point

Figure 2: Effect of demand shift on higher education market



⁴ Another factor in the increase in supply was the growth of the for-profit sector, which saw its enrollments in degree-granting institutions increase from 111,000 in 1980 to 2 million in 2010 (Snyder & Dillow, 2012).

⁵ This analysis and figure are adapted from Heller (2011).

given the market supply and demand before the increase in the college wage premium.

Curve D_1 is the demand for higher education as influenced by the increasing wage premium; at each price point, more students choose to enroll in college. The new equilibrium point is at the higher price P_1 and the increased enrollment Q_1 . Due to the relatively inelastic supply of higher education, the proportional increase in price is greater than the enrollment increase. This is borne out by the data: Between 1981 and 2009, total undergraduate enrollment in the nation increased 68 percent (Snyder & Dillow, 2012, table 214). Tuition prices (in current dollars) increased by more than 500 percent in four-year public and not-for-profit private institutions, as well as in community colleges. In the absence of such a demand shift, higher education institutions would not have been able to raise prices to such an extent over the last two decades *and* increase enrollments as they did.

III. The Research on Financial Aid and Tuition Prices

There have been a large number of research studies on tuition prices over the years, with most of these focusing on the impact that rising prices have on college enrollment, persistence, and degree attainment.⁶ Other studies, as described earlier, have focused on the overall determinants of the tuition price increases we have seen in recent years. Far fewer studies have focused on the role that federal financial aid may play in affecting price increases, and the results of these studies will be summarized in this section. The focus is on empirical research addressing the issue.⁷

One of the first studies to attempt to test the Bennett Hypothesis was conducted by economists Michael S. McPherson and Morton Owen Schapiro (1991). Using institutional data from the U.S. Department of Education's Integrated Postsecondary Education Data System (IPEDS) for the years from 1978 to 1985, they examined the relationship between a number of factors—including federal aid—and

⁶ For summaries of this research over the years, see Heller (1997), Jackson and Weathersby (1975), Kim (2010), and Leslie and Brinkman (1988).

⁷ Some policy think tanks have issued reports on the Bennett Hypothesis that do not include rigorous, empirical research to test it. For example, one report from the Cato Institute (Wolfram, 2005), a libertarian-oriented center, relied on its author's experiences as a trustee at a private college. Another, from the Center for College Affordability and Productivity (Gillen, 2012), is a theoretical analysis of the Bennett Hypothesis.

changes in gross tuition revenues during the period. The authors did find a positive relationship between federal aid revenues and tuition revenues at public universities, but not at private universities.⁸ They explain this finding by indicating that “only public four-year institutions can capture additional federal student aid revenue by raising their tuition levels under current arrangements” (p. 72).

In a dissertation from the Department of Economics at Harvard University (MA), Judith Li (1999) also used IPEDS data, along with data on Pell grant recipients at each institution, to conduct a multivariate analysis of the relationship between Pell grant awards and tuition prices from 1984 to 1994. While she did find a relationship at both public and private four-year institutions, she cautions that the inability to measure all variables that could impact institutions’ tuition-setting decisions may have impacted her results.

What is probably the most in-depth analysis on the determinants of college and university tuition prices was a study mandated by Congress in the 1998 reauthorization of the Higher Education Act of 1965 (Cunningham, Wellman, Clinedinst, Merisotis, & Carroll, 2001a, 2001b). In that reauthorization, Congress required that the U.S. Department of Education conduct a study to answer five primary questions:

- How have tuition and fees changed over time compared with inflation?
- How have the major expenditure categories (including capital and technology costs) changed over time?
- How are expenditures related to prices?
- To what extent does institutional aid (i.e., financial aid provided by institutions) affect tuition increases?
- To what extent has federal financial aid been used to offset increases in institutional aid (Cunningham et al., 2001a, p. 3)?

The study, which resulted in a 220-page report, utilized multivariate analyses of institutional data from the U.S. Department of Education’s IPEDS and Institutional Prices and Student Financial Aid Survey (IPSFA). The IPEDS and IPSFA data sets include information

⁸ The authors found that increases in federal aid revenues received at a private university were associated with increased institutional grant spending. They hypothesized that increased Pell grant awards encouraged private universities to enroll more Pell-eligible students, thus adding their own institutional grants on top of the Pell awards.

from all degree-granting, accredited postsecondary institutions, and data from the academic years 1988–89 to 1997–98 were analyzed. The report also included a review of the prior literature.

In order to examine whether the determinants of tuition price increases differ across different types of institutions, the study ran separate multivariate models for seven college sectors: public four-year research/doctoral institutions, public comprehensive institutions, public bachelor's institutions, community colleges, private research/doctoral institutions, private comprehensive institutions, and private bachelor's institutions.⁹ It also examined the relationship between tuition price increases and four types of financial aid: federal grants, state grants, institutional grants, and loans.¹⁰

Across these seven types of institutions, the study found no relationship between either federal or state grant aid, or loans, and tuition price increases:

Regarding the relation [sic] between financial aid and tuition, the regression models found no associations between most of the aid packaging variables (federal grants, state grants, and loans) and changes in tuition in either the public or private not-for-profit sectors (Cunningham et al., 2001a, p. 133).

The only relationship found between financial aid and price increases was for public and private comprehensive institutions, where there was a positive relationship between spending on institutional grants and tuition price increases.

Not surprisingly, in each of the public four-year sectors, the strongest predictor of tuition price increases was the change in revenue from state appropriations; as appropriations increased, tuition price increases were smaller, and as appropriations decreased (or increased more slowly), price increases were greater. At private institutions, tuition price increases were driven primarily by increased costs, including things such as instructional expenditures, faculty salaries, and institutional grant spending. However, price increases at private institutions were also affected by revenues from other sources, including endowment income, gifts, and other grants and contracts.

⁹ For public institutions, the outcome used in the models was the change in tuition for in-state students.

¹⁰ The analyses focused on aid received by first-time, full-time undergraduate students.

A third study utilized a similar methodology of examining institutional-level data over a period of time, but came to a different conclusion (Singell & Stone, 2007). It analyzed data from 1989 to 1996, examining the relationship between the Pell grants received by students at four-year public and private universities and tuition prices. This study had two key differences from the U.S. Department of Education study described above. First, rather than using the year-to-year increase in tuition prices as the outcome of interest, these authors use the absolute amount of tuition each year as the outcome. Second, rather than using the total volume of Pell dollars received at each institution, they instead used just the size of the average Pell grant award (for students who received a Pell grant).

The study found no relationship between the average size of Pell awards and in-state tuition prices at public universities, but did find a positive relationship between Pell and the out-of-state tuition prices in public universities and between Pell and prices at private universities. The applicability of these results is limited, however, because the authors did not have data on the total volume of Pell grants received at each institution. Thus, a change in the size of the average Pell grant award may not have much relationship to the total volume of Pell dollars received at that institution. For example, while the average award could increase by 10 percent, if there were a corresponding decrease in the number of Pell recipients, this could lead to a reduction in the volume of Pell dollars received at the institution. The study also suffered from not having data on the other types of aid (state and institutional grants, as well as loans) that students received at each institution. Thus, it is difficult to ascribe much meaning to the relationships found by the authors.

Another study utilized a similar methodology and IPEDS data, limiting its scope to public flagship universities during the period from 1979 to 1998 (Rizzo & Ehrenberg, 2004), but came up with very different results. While Singell and Stone found no relationship between Pell grant awards and in-state tuition, they did find a positive relationship between Pell and out-of-state tuition. Rizzo and Ehrenberg's findings were exactly the opposite: They found no effect for out-of-state tuition, but did find an impact on in-state tuition. However, like the earlier study, Rizzo and Ehrenberg's methodology suffers from having an imperfect measure of Pell grants. It uses the

maximum Pell grant award available to students each year, rather than the total volume of Pell dollars received in each institution. In addition, the institutions studied included only public flagship universities, so the generalizability to other sectors of higher education is limited.

One more article using IPEDS data (from 2002 through 2007) focused on community colleges. Frederick, Schmidt, and Davis (2012) looked at the relationship between tuition prices and the average federal grant aid received by students at the institution.¹¹ Like the other studies, this one is limited by its short time horizon and by limited measures of institutional financial behavior. The authors did conclude, however, that “state and college officials do not appear to appropriate increases in Federal student aid or Federal funds” (p. 915).

Economists Robert B. Archibald and David H. Feldman (2011) also tested the Bennett Hypothesis in their book *Why Does College Cost So Much?* by applying a Granger test, which attempts to discern causality between two variables by looking at the temporal relationship between the two. In other words, for one variable to cause a change in a second, there should be discernible pattern of change in the first that consistently causes a subsequent change in the second. Their application of the Granger test found no relationship between increases in the authorized maximum Pell award and tuition at public universities, and found an inverse relationship in private universities, i.e., larger increases in the maximum Pell grant were associated with decreases in tuition at private institutions. The authors concluded, “Our results are not encouraging for the conjecture known as the Bennett Hypothesis.”

In a recent analysis that is one of the few empirical analyses of tuition price setting in the for-profit sector, Cellini and Goldin (2012) used data from three states—Florida, Michigan, and Wisconsin—to examine tuition prices in two types of for-profit institutions: those that are accredited by an agency recognized by the U.S. Department of Education, which allows the institution to participate in the federal Title IV programs, and those that are not accredited in this fashion. The authors compared institutions offering similar academic or vocational programs in these two categories (Title IV participating

¹¹ This study included measures of the average state and institutional grants received by students.

and non-Title IV participating) in order to test the hypothesis that at least part of the difference in price could be ascribed to the availability of federal grant aid to students at colleges in the former but not the latter category.

The authors control for a number of other characteristics of the schools, including measures of quality, in order to attempt to isolate the impact of Title IV participation on tuition rates. Even while acknowledging that there may be other unobservable factors that could contribute to these tuition price differences, they do find that the differences in tuition prices map very closely to the average amount of federal grant aid received by students attending the Title IV-participating institutions. They conclude that this “finding is suggestive of the ‘Bennett hypothesis’ of federal aid capture” (p. 22). Like the other studies, this one too has limitations that should cause one to be cautious in interpreting the findings. First, the data are from just three states, which are not necessarily representative of the for-profit sector in the rest of the country. Second, while the authors controlled for some of the factors that distinguish those institutions that participate in the federal Title IV programs and those that do not, there are likely still other unmeasurable characteristics that distinguish these two types of for-profit colleges and their tuition rates.

IV. Summary and Conclusions

As described in the introduction, the best way to characterize the studies that have attempted to measure the veracity of the Bennett Hypothesis is that the findings are ambiguous. Some studies find a relationship between Pell grants and tuition increases; others do not. Some find a relationship in some college sectors but not others, and other studies find exactly the opposite result.

In all of these studies, there are major limitations that restrict our ability to draw hard-and-fast conclusions regarding the Bennett Hypothesis. The first issue is the imprecision with which the researchers measure key variables, including Pell grant awards at the institution, as well as other components of financial aid. Ideally, one would need student-level data across a large number of colleges and universities for multiple years that would provide detailed information about the financial aid offers and awards of both students who applied to the institutions as well as students who enrolled. None of

the studies had data that even came close to containing this level of detail.

A second major problem with all of these studies is one that economists refer to as “omitted variable bias,” or the inability to include in statistical models key predictor or control variables that are related to the outcome of interest. The student-level data noted above would need to be combined with accurate, institution-level information about all of the expense and revenue categories in colleges and universities that help inform the decisions institutions make when they set tuition prices.

Without accurate data it is impossible to accurately model, or even approximate, what the true supply and demand curves are for an institution, or a group of institutions, as shown in Figure 2. Without the ability to discern the supply and demand, it is difficult to determine with any degree of certainty how an external shock to the system—such as an increase in Pell grant awards—would affect the equilibrium point of the higher education market, and thus, what the impact would be on tuition prices and the number of students who enroll.

The reality is that the setting of tuition prices is a multifaceted exercise. At private colleges and universities, the boards of trustees generally set the tuition price each year, and they use a variety of data in making their decision, including:

- Recent years’ financial results;
- Projections of future expenses;
- Projections of future revenue streams, including the availability of state and federal financial aid;
- Estimates of enrollment demand;
- A review of competitors’ past price-setting and enrollment actions and estimates of future such actions; and
- An analysis of the political environment.¹²

Each of these components of the tuition-setting process will carry different weight in a given year; in some years, the actions of competitors may have more influence over the tuition rate that is set. In other years, projections of future expenses may be more of a determinant.

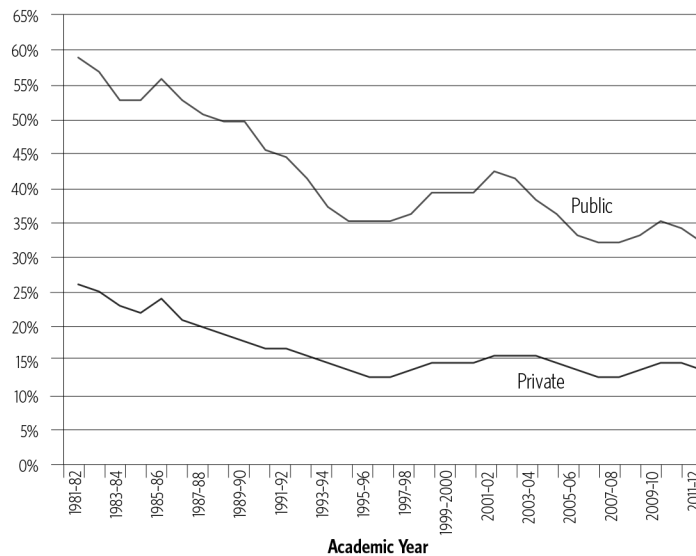
¹² See Clotfelter (1996), Ehrenberg (2000), and Feerrar (2005) for explanations of this process.

Public universities are more mixed as to how tuition rates are established. In some states, the rates are set for all public institutions by the state governing or coordinating board. In others, the legislature is involved, and in still others, individual institutions can establish their own rates (Hearn, Griswold, & Marine, 1996; Lowry, 2001; McGuinness, Epper, & Arredondo, 1994). As is the case at private universities, no matter who has the authority, tuition rates are established based on multiple variables, so the role of one factor—such as the funding for the Pell grant program or what the maximum award will be in the next year—is naturally limited.

Another consideration in understanding the role that federal aid may play in incentivizing institutions to raise tuition prices is to look at what proportion of students' college costs is covered by federal aid. Figure 3 shows the percentages of the average annual combined price of tuition, fees, room, and board at four-year public and private institutions that were covered by the maximum Pell grant award over the last three decades. In 1981, the maximum Pell award of \$1,670 would have covered 58 percent of a student's annual costs at the average-priced public institution and 26 percent of such costs at a private institution. By 2011, these amounts had dropped to 32 percent and 14 percent, respectively. Thus, to have a significant impact on the tuition-setting behavior of colleges and universities, especially in light of all the other competing factors that go into establishing tuition rates, Pell awards would have to increase substantially. Given this pattern, it is not surprising that most of the studies that found a relationship between Pell awards and tuition prices were those using data from the 1980s and early 1990s.

It is also important to remember that increases in Pell awards affect only those students receiving Pell grants; they have no impact on students who do not qualify for the program. The most elite colleges and universities in the country, which also tend to be the most expensive, generally enroll the lowest number of students receiving Pell grants (Carnevale & Rose, 2004; Heller, 2004). Pell grant recipients tend to be enrolled foremost in community colleges, which offer the lowest tuition, and after that, in lower-selectivity (and lower-priced) public institutions. The exception to this pattern may be the for-profit colleges, many of which enroll relatively large numbers of Pell grant awardees.

Figure 3: Maximum Pell grant award amounts as a percentage of average annual tuition, fees, and room-and-board charges at four-year institutions



Source: Author's calculations from College Board (2011), *Trends in College Pricing: 2011* and *Trends in Student Aid: 2011*.

One may question why the studies described in section three focused primarily on the relationship between federal grants and tuition prices, but not federal loans. After all, former secretary Bennett singled out federal loan subsidies as the culprit behind tuition increases. But while loans (both federal and private) are often considered financial aid, their role is very different from that of grants. While grants provide an actual cash discount to the amount that students have to pay to attend college, loans instead have the purpose of allowing students to postpone when they pay for college. And depending upon the loan terms, including interest rates, origination fees, and repayment term, a loan can increase the cost of attending college. An apt analogy can be made between student loans and car loans. Nobody thinks of a car loan as a discount to the price of the car; it simply makes the purchase more affordable by stretching

out the payments over time. A student loan has the same purpose for acquiring a college education.

It is also hard to conclude that increases in borrowing limits under the federal loan programs could have much impact on the increase in tuition prices at the nation's colleges and universities. Table 3 shows the borrowing limits in the Subsidized Federal Stafford Loan program from 1987—the year then secretary Bennett wrote his op-ed—to 2012. With the exception of the borrowing limit for sophomores, which increased 71 percent over the last 25 years, all of the other limits increased less than 40 percent. And this was during an era when tuition prices increased by more than 300 percent at public and private four-year institutions, as well as at community colleges.

While the Bennett Hypothesis may be intriguing, there is little compelling evidence that it holds true with respect to the price-setting behavior of colleges and universities in the United States. This complex process involves far too many variables for it to be essentially explained by the simplistic notion that tuition-setting boards sit around and say, “Well, Pell grants are going up \$200 next year, so we can raise tuition \$100.” While any change in federal aid may be a very small piece of the puzzle that leads to year-to-year tuition increases, there is scant evidence that it is a major contributing factor.

Table 3: Subsidized Federal Stafford Loan program borrowing limits, 1987 to 2012

	Freshman	Sophomore	Junior	Senior	Aggregate
1/1/87 to 9/30/92	\$2,625	\$2,625	\$4,000	\$4,000	\$17,250
10/1/92 to 6/30/93	\$2,625	\$2,625	\$4,000	\$4,000	\$23,000
7/1/93 to 9/30/93	\$2,625	\$3,500	\$5,500	\$5,500	\$23,000
10/1/93 to 6/30/07	\$2,625	\$3,500	\$5,500	\$5,500	\$23,000
7/1/07 to 6/30/12	\$3,500	\$4,500	\$5,500	\$5,500	\$23,000
7/1/12 to present	\$3,500	\$4,500	\$5,500	\$5,500	\$23,000
Change, 1987 to 2012	33%	71%	38%	38%	33%

Note: Amounts are for dependent students. Aggregate amounts include unsubsidized loans.

Source: FinAid. (n.d.). “Historical Loan Limits.” Retrieved from <http://www.finaid.org/loans/historicallimits.phtml>.

References

- Archibald, R. B., & Feldman, D. H. (2011). *Why does college cost so much?* Oxford, UK: Oxford University Press.
- Bennett, M. J. (1996). *When dreams came true: The GI Bill and the making of modern America*. Washington, DC: Brassey's, Inc.
- Bennett, W. J. (1987, February 18). Our greedy colleges. *The New York Times*, p. A31.
- Bersudskaya, V., & Chang Wei, C. (2011). *Trends in student financing of undergraduate education: Selected years, 1995-96 to 2007-08*. Washington, DC: U.S. Department of Education, National Center for Education Statistics.
- Carnevale, A. P., & Rose, S. J. (2004). Socioeconomic status, race/ethnicity, and selective college admissions. In R. D. Kahlenberg (Ed.), *America's untapped resource: Low-income students in higher education* (pp. 101-156). Washington, DC: Century Foundation Press.
- Cellini, S. R., & Goldin, C. (2012). *Does federal student aid raise tuition? New evidence on for-profit colleges* (Working paper no. 17827). Cambridge, MA: National Bureau of Economic Research.
- Clotfelter, C. T. (1996). *Buying the best: Cost escalation in elite higher education*. Princeton, NJ: Princeton University Press.
- College Board. (2011a). *Trends in college pricing: 2011*. Washington, DC: Author.
- College Board. (2011b). *Trends in student aid: 2011*. Washington, DC: Author.
- Cunningham, A. F., Wellman, J. V., Clinedinst, M. E., Merisotis, J. P. & Carroll, C. D. (2001a). *Study of college costs and prices, 1988-89 to 1997-98, Volume 1*. Washington, DC: U.S. Department of Education, National Center for Education Statistics.
- Cunningham, A. F., Wellman, J. V., Clinedinst, M. E., & Merisotis, J. P. & Carroll, C. D. (2001b). *Study of college costs and prices, 1988-89 to 1997-98, Volume 2: Commissioned papers*. Washington, DC: U.S. Department of Education, National Center for Education Statistics.

- Ehrenberg, R. G. (2000). *Tuition rising: Why college costs so much*. Cambridge, MA: Harvard University Press.
- Feerrar, P. W. (2005). *The impact of the recent financial market downturn on private liberal arts colleges* (unpublished doctoral dissertation). University Park, PA: The Pennsylvania State University.
- FinAid. (n.d.). Historical loan limits. Retrieved from <http://www.finaid.org/loans/historicallimits.phtml>
- Frederick, A. B., Schmidt, S. J., & Davis, L. S. (2012). Federal policies, state responses, and community college outcomes: Testing an augmented Bennett hypothesis. *Economics of Education Review*, 31(6), 908–917.
- Gardner, L., & Blumenstyk, G. (2012, August 13). At Calif. public colleges, dreams deferred. *The Chronicle of Higher Education*. Retrieved from <http://chronicle.com/article/For-Golden-States-Public/133565/>
- Gillen, A. (2012, February). *Introducing Bennett Hypothesis 2.0*. Washington, DC: Center for College Affordability and Productivity.
- Greenberg, M. (1997). *The GI Bill: The law that changed America*. New York, NY: Lickle Publishing.
- Hearn, J. C., Griswold, C. P., & Marine, G. M. (1996). Region, resources, and reason: A contextual analysis of state tuition and student-aid policies. *Research in Higher Education*, 37(3), 241–278.
- Heller, D. E. (1997). Student price response in higher education: An update to Leslie and Brinkman. *The Journal of Higher Education*, 68(6), 624–659.
- Heller, D. E. (2004). Pell Grant recipients in selective colleges and universities. In R. D. Kahlenberg (Ed.), *America's untapped resource: Low-income students in higher education* (pp. 157–166). Washington, DC: Century Foundation Press.
- Heller, D. E. (2011). Trends in the affordability of public colleges and universities: The contradiction of increasing prices and increasing enrollment. In D. E. Heller (Ed.), *The states and public higher education policy: Affordability, access, and accountability* (2nd ed., pp. 13–36). Baltimore, MD: The Johns Hopkins University Press.
- Jackson, G. A., & Weathersby, G. B. (1975). Individual demand for higher education. *The Journal of Higher Education*, 46(6), 623–652.

- Kane, T. J., & Rouse, C. E. (1995). Labor-market returns to two- and four-year college. *The American Economic Review*, 85(3), 600-614.
- Kim, J. (2010). The effect of prices on postsecondary access: An update to Heller. *Higher Education in Review*, 7, 23-46.
- Knapp, L. G., Kelly-Reid, J. E., & Ginder, S. A. (2012). *Enrollment in postsecondary institutions, fall 2010; financial statistics, fiscal year 2010; and graduation rates, selected cohorts, 2002-07*. Washington, DC: U.S. Department of Education, National Center for Education Statistics.
- Leslie, L. L., & Brinkman, P. T. (1988). *The economic value of higher education*. New York, NY: Macmillan Publishing.
- Levy, F., & Murnane, R. J. (1992). U.S. earnings levels and earnings inequality: A review of recent trends and proposed explanations. *Journal of Economic Literature*, 30, 1333-1381.
- Li, J. (1999). *Estimating the effect of federal financial aid on higher education: A study of Pell grants* (Unpublished doctoral dissertation). Cambridge, MA: Harvard University.
- Lowry, R. C. (2001, October). Governmental structure, trustee selection, and public university prices and spending: Multiple means to similar ends. *American Journal of Political Science*, 45(4), 845-861.
- McGuinness, A. C., Jr., Epper, R. M., & Arredondo, S. (1994). *State post-secondary education structure handbook 1994*. Denver, CO: Education Commission of the States.
- McPherson, M. S., & Shapiro, M. O. (1991). *Keeping college affordable: Government and educational opportunity*. Washington, DC: Brookings Institution Press.
- Morganthau, T., & Nayyar, S. (1996, April 29). Those scary college costs. *Newsweek*, 53-56.
- Mumper, M. (1996). *Removing college price barriers: What government has done and why it hasn't worked*. Albany, NY: State University of New York Press.
- Mumper, M., & Freeman, M. L. (2011). The continuing paradox of public college tuition inflation. In D. E. Heller (Ed.), *The states and public higher education policy: Affordability, access, and accountability* (2nd ed., pp. 37-60). Baltimore, MD: The Johns Hopkins University Press.

- Murnane, R. J., Willett, J. B., & Levy, F. (1995). The growing importance of cognitive skills in wage determination. *Review of Economics and Statistics*, 77(2), 251-266.
- Murphy, K., & Welch, F. (1992). Wages of college graduates. In W. E. Becker & D. R. Lewis (Eds.), *The economics of American higher education* (pp. 121-140). Boston, MA: Kluwer Academic Publishers.
- Rizzo, M. J., & Ehrenberg, R. G. (2004). Resident and nonresident tuition and enrollment at flagship state universities. In C. M. Hoxby (Ed.), *College choices: The economics of where to go, when to go, and how to pay for it* (pp. 303-353). Chicago, IL: The University of Chicago Press.
- Samuelson, P. A. (1976). *Economics* (10th ed.). New York, NY: The McGraw-Hill Book Companies, Inc.
- Singell, L. D., Jr., & Stone, J. A. (2007). For whom the Pell tolls: The response of university tuition to federal grants-in-aid. *Economics of Education Review*, 26(3), 285-295.
- Snyder, T. D., & Dillow, S. A. (2012). *Digest of education statistics 2011*. Retrieved from U.S. Department of Education, National Center for Education Statistics website: <http://nces.ed.gov/programs/digest/>
- State Higher Education Executive Officers. (2012). *State higher education finance FY 2011*. Boulder, CO: Author.
- U.S. Department of Education, National Center for Education Statistics. (2010). Integrated Postsecondary Education Data System (IPEDS) 12-month enrollment survey, 2010 [Data file].
- U.S. Department of Education, Office of Postsecondary Education. (2012). *2010-2011 Federal Pell Grant Program end-of-year report*. Washington, DC: Author.
- Wolfram, G. (2005, January). *Making college more expensive: The unintended consequences of federal tuition aid*. Washington, DC: Cato Institute.
- Zucker, B., & Dawson, R. (2001). *Credits and attainment: Returns to post-secondary education ten years after high school*. Washington, DC: U.S. Department of Education, National Center for Education Statistics.

EXTENDED TESTIMONY OF RICHARD K. VEDDER
 DIRECTOR, CENTER FOR COLLEGE AFFORDABILITY AND PRODUCTIVITY
 SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS
 UNITED STATES HOUSE OF REPRESENTATIVES
 WASHINGTON, D.C., OCTOBER 7, 2015

Higher Education in the U.S. Federal Tax System

Using standard criteria to evaluate the U.S. system of income taxation, it is usually found deficient on three important grounds: it is excessively complex, raising administrative costs as well as problems of non-compliance; it is extremely inefficient, leading to distortions in the allocation of resources and ultimately lower rates of economic growth; and in some ways it is perceived as unfair, certainly violating generally accepted standards of horizontal equity (treating everyone of similar economic circumstance the same) if not vertical equity. The treatment of higher education in the tax code aggravates and magnifies these deficiencies in my judgement.

Let me name a few explicit examples, mainly related to endowments and gifts. Individuals who buy and sell securities are subject to capital gains taxes that effectively have rates as high as 23 percent; universities, by contrast, that buy and sell securities pay nothing. This adds to complexity (some gains are taxable, others are not), perhaps creates vertical inequities (some pay the tax, others are exempt), and even inefficiencies as the lack of a level playing field favors some investors over others, potentially distorting the allocation of resources.

Similarly, donations to universities are tax-exempt, whereas the gift of a few dollars to a beggar on the streets or to an impoverished relative is generally not. Donations to fund purely non-academic facilities are tax-exempt if made through universities, but taxable if done by for-profit firms providing similar services to the public. Thus there are examples of university housing facilities where the cost per bed exceeds \$300,000 –more than many luxury hotels cost. The donor has his or her tax liability reduced by millions, but for what social purpose? Similarly, many decry spending on fancy athletic facilities, including stadium sky boxes, on similar grounds. Why should a person be able to reduce her or his taxes by supporting ball throwing contests?

But these more egregious examples of potential misuse of the tax code are quantitatively probably far less important than activity that seemingly supports arguably highly legitimate academic functions. In this testimony, I look only at one category, university endowments, for reasons of space and time, not examining non-endowed gifts to schools. My testimony is somewhat tentative, in that my research into the subject is continuing and not complete. But early findings are still interesting and worth some discussion.

The Argument Against Endowments: Adam Smith

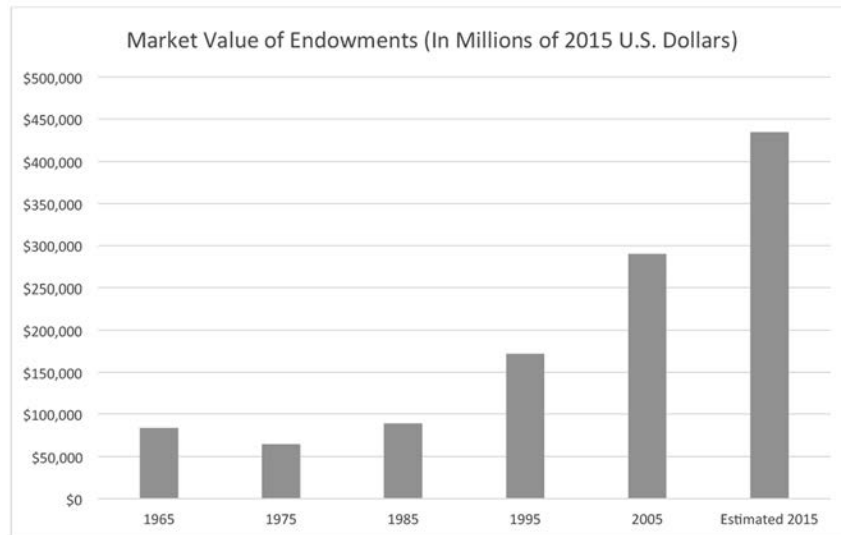
In the first great book in economics written in the year of our independence (1776), Adam Smith said: “have...endowments contributed in general to promote the end of their institution? Have they contributed to encourage the diligence and to improve the abilities of the teachers? Have they directed the course of education towards objects more useful, both to the individual and to the public, than those to which it would naturally have gone of its own accord?” Smith then goes on for several pages to argue the answer to these questions is “no.” Endowments work to make professors less diligent, for example, since the subsidies from endowments mean there are no consequences from bad teaching, unlike in a world where professors depend on student fees directly for their income. Oxford University had given up the practice of individual professors charging student fees, relying instead largely on endowments. Smith’s conclusion as a consequence “the greater part of the ...professors...have...given up altogether the pretence of teaching.”

Endowments in America: Some Tentative Evidence

Was Smith onto something when he argued that endowment subsidies, like other subsidies, often encourage inefficiencies, because they reduce the financial need for providers to be responsive to customer needs? Certainly endowments have grown dramatically over time, even after correcting for inflation, as Figure 1 indicates. While the 2015 figure is partially estimated, the evidence suggests more than complete recovery from the considerable endowment drop associated with the 2008 financial crisis. Endowments have risen over five-fold after adjusting for inflation over the past half century and, as Figure 2 shows, fairly considerably even after adjusting for enrollment growth.

Endowments are very unequally distributed among schools, as Figure 3, using U.S. Department of Education data, indicates. Just 30 universities have collectively larger endowments than all other universities combined. Roughly one-third of endowments are in the top 10 schools. Table 1 provides details as of 2014. Harvard’s endowment as of June 30, 2015 totaled \$37.6 billion, more than *100 times as large* as that at many other universities, both public and private, of similar size.

Figure 1
Growth of Endowments, Inflation-Adjusted, 1965-2013



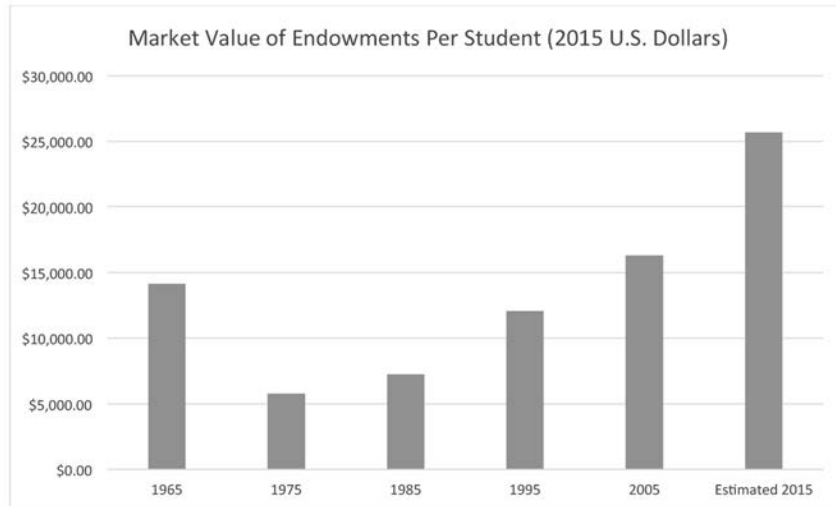
Source: U.S. Department of Education, National Association of College and University Business Officers (NACUBO)

The assistance to universities provided by tax preferences is thus very heavily skewed, favoring a relatively small number of mostly highly selective private universities that some might regard as elitist or exclusionary, especially since these schools generally have admissions preferences for children of alumni under so-called legacy provisions. Endowments provide colleges with roughly \$20 billion of income, about four percent of all college revenues, but roughly 35 percent at some highly endowed institutions. In general, endowments have grown faster than revenues over time.

With the assistance of an economics and statistics undergraduate student at Ohio University, Justin Strehle, I have used data provided annually by the National Association of College and University Business Officers, NACUBO. The NACUBO survey records information on over 800 endowments, some of them non-university or Canadian institutions. For a majority of those institutions, the research organization that I direct, the Center for College Affordability

and Productivity (CCAP), collects extensive data in the process of ranking the nation's best colleges for *Forbes* Magazine. For most of the analysis reported here, there are 467 schools in the sample, including every large American university endowment reported by NACUBO.

Figure 2

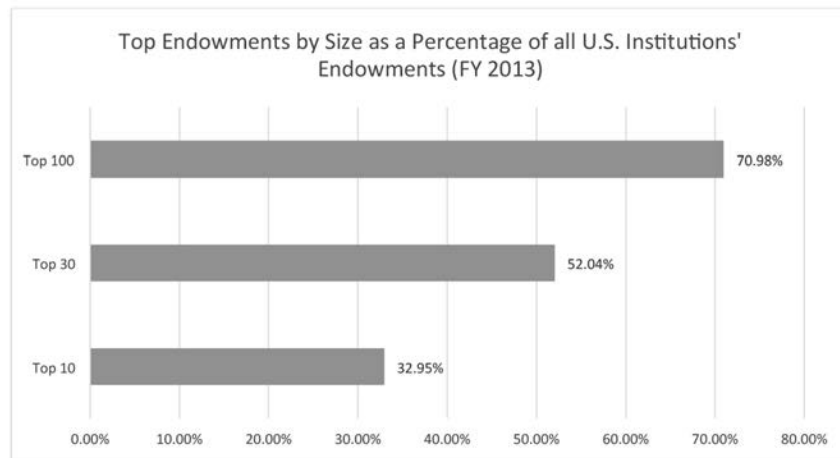


Source: U.S. Department of Education, NACUBO

As indicated, endowments provide colleges with about \$20 billion of income available for expenditure, independent of annual changes in the value of investment portfolios resulting from changing market valuations. These changes, largely but not entirely reflecting capital gains, are often very sizable –Harvard's endowment rose about \$1.7 billion (or nearly \$100,000 per full-time student studying in Cambridge), despite a generally disappointing rate of return on investments in fiscal year 2015. In general, endowments have grown faster than revenues over time. Moreover, statistics on the rate of return on college endowments in recent years have generally shown that the rate of return on endowment income has been higher at the schools with large endowments. Those schools, with huge endowment incomes, can more readily afford to take relatively large risks, and can make investments of say \$250 million or more in a single security or piece of real estate with high potential, something small endowed schools cannot safely do. It is therefore probably true that the tax-free nature of capital gains income for universities works to help the wealthier schools relative to the less affluent ones who tend to earn lower rates of return on investments. It is also worth noting that at least one account suggests that

the investment fees to top managers at large university endowments have been known to exceed \$100 million annually, so one might argue that huge investment gains enabled by tax privileges have led to extremely high incomes to a very few individuals. It has been argued that in some cases investment managers make more than the university expends on endowed scholarships payments to students.

Figure 3



Source: Author's Calculations, U.S. Department of Education data

Returning to the analysis of endowments, Mr. Strehle and I used multiple regression techniques to assess the relationship between endowments and a number of variables that some consider important. We have asked, for example, about the relationship between student tuition fees and endowments, whether there seems to be a strong relationship between institutional quality and endowment size, and whether compensation of faculty is positively associated with the size of university endowments.

In order to analyze the relationship between endowments and, say, tuition fees, we have to control for other possible determinants of those fees. In the results discussed below, we have typically included a dozen or so of these control variables, such as whether a school is public or private, the extent it has high proportion of students of modest income (as measured by Pell Grants), the degree of selectivity of the institution (as measured by standardized test scores), the

racial and ethnic composition of the student body, whether the institution is large or small, whether it is located in an urban area or rural area, and so forth.

Table 1

10 Largest Endowments: June 30, 2014

Institution	Endowment Size for FY 2014 (Thousands)
Harvard University (MA)	35,883,691
University of Texas System	25,425,922
Yale University (CT)	23,900,000
Stanford University (CA)	21,446,006
Princeton University (NJ)	20,995,518
Massachusetts Institute of Technology	12,425,131
The Texas A&M University System and Foundations	11,103,880
Northwestern University (IL)	9,778,112
University of Michigan	9,731,460
University of Pennsylvania	9,582,335

Source: National Association of College and University Business Officers (NACUBO)

A few conclusions have tentatively emerged. First, endowments are *not* generally used to lower the stated tuition fees of colleges. There is *no* statistically significant relationship between endowment size and tuition fees. There *are* exceptions – Berea College in Kentucky, the College of the Ozarks in Missouri, and, historically, Cooper Union in New York City have used investments to essentially eliminate student fees. At one time, Rice University was tuition free but that policy was abandoned decades ago. Using endowments primarily to keep student fees low is very rare -- as a rule, endowments add to university income, rather than lower student costs.

Second, having said that, however, there is one caveat. Endowments are used some to provide scholarships, effectively lowering the actual or net tuition fee paid by students. However, assuming a four or five percent payout rate, the evidence suggests typically that less than 20 cents out of every dollar of endowment income goes for this purpose – making college more affordable is not the dominant use of endowed resources.

Third, because of inherent measurement issues, it is difficult to assess the relationship between endowments and institutional quality. *Forbes* Magazine ranks schools mainly on how

they satisfy student needs—do students like their professors, excel vocationally after graduation, avoid much debt, get nationally recognized academic awards or graduate in a timely manner? Controlling for other factors such as those discussed above, there is *no* statistically significant relationship between the quality of the institution (as measured by *Forbes*) and endowment size. A caveat is in order here: alternative measures of quality, such as those done by *US News & World Report* or by *Money Magazine*, might show a different result. Given the relatively high correlation between the various magazine rankings, however, it is unlikely that there is any strong positive relationship between a composite of magazine rankings and endowment size—endowments are almost certainly not a dominant determinant of perceived quality.

Fourth, there is some indication that some endowment funds go to increase faculty compensation at institutions. In some cases, this might lead to higher quality teachers and researchers, but it might also be accompanied by an excessive bureaucracy, or unjustified pay increases, rather than meeting student needs. The evidence here is necessarily somewhat murky, but raises real questions about whether endowment funds mainly serve social objectives justifying special tax treatment. Further analysis of the relationship between institutional expenditures and endowments is certainly needed.

Are College Tax Preferences Justified? Some Contrarian Thoughts

Governments either tax or subsidize almost all economic activities. Universities are typically subsidized, often directly, through governmental appropriations or grants, and/or indirectly, through various tax preferences (typically schools benefit from both subsidies and preferences). The justification for giving tax treatment to universities that is better than, say, given used car dealers or providers of mobile telephones, is that colleges have two special attributes. First, it is argued that higher education is a public good with large positive externalities or spillover effects. When a person goes to college, he or she likely benefits financially, but also others surrounding that person derive some benefits as well. For example, if a college educated person goes to work in an office, the non-college educated workers in the office may strive to succeed more to look good in relation to the college educated person.

Second, it is argued that in today's economy where human financial gain depends strongly on mental capacities and efforts, higher education is virtually a necessary condition for achieving economic advance. Therefore, individuals from lower income background trying to move up the financial ladder need special subsidization in order to allow them to at least attempt to achieve the American Dream.

Both of these arguments are at least debatable. If higher education has positive economic externalities (e.g., generally raising labor productivity), you would expect state and local governmental appropriations to higher education to have some positive effects on income

creation—more per capita income. I have run hundreds of regression equations looking at the statistical relationship between state government university appropriations and the rate of economic growth and have observed no meaningful relationship or, worse, a negative relationship.

Higher education is a notoriously inefficient industry, and while productivity is hard to measure for several reasons, not even the most ardent advocate of spending more on universities argues that productivity in this sector is rising significantly. Under some reasonable sets of assumptions it is at best stagnant and more likely falling. University staff per student, for example, has risen over time, hinting that inputs could be rising faster than outputs—a sign of declining productivity. When we tax resources to fund university subsidies, and when we give universities tax preferences, we are taking resources from the highly productive, competitive and market-disciplined private sector and giving them to the far less productive, far less market-driven, and far less competitive higher education sector, perhaps explaining why it is not uncommon to find a negative association between higher education spending and economic growth. All in all, this statistical evidence makes it hard to believe that higher education produces meaningful positive economic externalities.

Probably the leading free market, libertarian-leaning American economist of the twentieth century was Milton Friedman. In *Capitalism and Freedom*, written in 1962, Friedman argued that government subsidies of universities were justified on positive externality grounds. When I asked him 40 years later about this, Friedman said that while some positive externalities existed, so did some negative ones, and he was uncertain whether we should tax or subsidize universities, arguing it was a matter for empirical examination. In Friedman's view, the long-held assumption that higher education needed subsidies certainly needed reexamination.

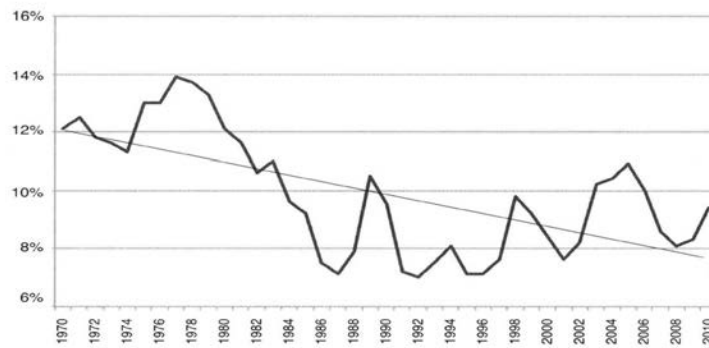
Some trends in higher education in the era of high endowments and growing use of tax preferences (among the most important of which are tax credits to effectively reduce tuition fees for students, and tax exemption of interest on some bonds issued, usually to fund capital outlays) add to my skepticism that endowments serve a clear positive social purpose. Take the goal of achieving greater intergenerational income mobility and reductions in measured inequality. In the last 40 years, income inequality has risen relatively steadily with growing endowments and university enrollments. Moreover, within higher education, *the proportion of recent American college graduates from the bottom quartile of the income distribution is lower today than in 1970*—not only before big endowments, but before large federal student financial assistance programs as well (see Figure 4).

Moreover, even forgetting the public good dimension of higher education, there is growing evidence that the perceived rate of return on higher education investment at the margin is becoming relatively low. If you view tax preferences as a means of increasing investment in

human capital, the argument for doing so is markedly reduced if the incremental rate of return on that investment is perceived to be low. Recent college graduates certainly see the gains from a

Figure 4

BOTTOM FAMILY INCOME QUANTILE: SHARE OF BACHELOR'S DEGREES AT AGE 24



Source: Postsecondary Education Opportunity, PEO, postsecondary.org

college education to be far from strong, with fully one-half of recent graduates in the Purdue-Gallup annual poll of 30,000 alumni finding higher education not a particularly good investment. Beyond that, the New York Federal Reserve and others, including myself, have observed that conservatively 40 percent of recent college graduates end up taking jobs that historically have been filled by high school graduates. Should we be giving very valuable tax exemptions to schools that at extremely high cost educate many to become taxi drivers, baristas, retail sales clerks in discount stores, and janitors?

Some Concluding Thoughts

What should America do with respect to endowments? In a world where the federal government did not interfere in higher education markets at all, I would be inclined to say "do nothing." Individuals wishing to donate to their alma mater should be able to do so as part of the basic economic freedom generally accorded Americans. But the government is significantly interfering in those markets already with massive subsidies, tax preferences and regulations, mainly at the federal but also at the state and local level.

Looked from the broader view of American tax reform, I think a strong case can be made for eliminating most if not all higher education tax preferences. Economists are right in thinking that taxing a broad tax base at relatively low marginal rates is likely to have enhanced output effects relative to taxing a relatively narrow tax base at varying but sometimes high marginal rates. This is an argument for ending endowment related tax preferences.

Introducing equity into consideration, I am the first to argue that tax fairness is a highly subjective concept, and what is considered fair by one person may be perceived as unfair by another. That said, however, the current higher education tax preferences almost certainly benefit highly selective, mostly private schools with relatively low proportions of Pell Grant and other low income recipients despite their financial capacity to finance the education of many poorer students. The existence of admission legacy provisions means that to some extent the more elite schools have dimensions of a private club or a gated academic community, where money and who your parents are makes a difference. I believe purely private clubs should be able to exclude members on any basis, even ones that I personally find reprehensible. But I do not think that exclusionary principle applies when the club in question, be it Yale University or Slippery Rock State University, receives federal subsidies that arguably contribute to the perpetuation of non-merit based selection procedures advantaging mainly wealthy Americans.

It is possible, of course, to compromise. Keep endowment preferences up to a certain limit. Start to eliminate deductions for donations to institutions with more than \$250,000 endowment per student, for example, probably phasing out the deductions over a fairly large range of endowment per student. One can argue about where to begin a phase-out, or whether or where even to implement an excise tax on endowment incomes. One can argue whether revenue enhancements from ending preferences should be used to reduce the budget deficit, lower taxes, or provide aid to augment endowments of poorer schools. I am not sure myself what optimal policy is, but I must say I am much more skeptical of the justification for current tax preferences towards higher education than I was when I first began studying this issue more than one half century ago.

Thank you.

Richard Vedder is Distinguished Professor of Economics Emeritus at Ohio University, Director of the Center of College Affordability and Productivity, and Adjunct Scholar at the American Enterprise Institute. He was immeasurably assisted by Justin Strehle, an economics and statistics undergraduate major at Ohio University. Regression results discussed in the testimony are available be request.

[Submissions for the Record follow:]



Statement for the
Committee on Ways and Means
Subcommittee on Oversight
U.S. House of Representatives
October 7, 2015
The Rising Costs of Higher Education and Tax Policy

The Business Coalition for Fair Competition (BCFC) is a coalition of private sector firms, large and small, trade associations, think tanks, organizations, and individuals who support the competitive free enterprise system and seek relief from unfair government sponsored competition with private business.

BCFC is deeply concerned that some universities operate activities in direct and unfair competition with for-profit, tax-paying private businesses. At a time when small business is struggling and job creation is not being maximized in the private sector, small business cannot afford to compete against universities that don't pay their fair share of taxes.

Private enterprise constitutes the strength of the United States economic system and competitive private enterprises remain the most productive, efficient, and effective sources of goods and services.

There are thousands of legitimate institutions of higher education that do exemplary work training the future workforce. The tax treatment of these institutions is not an issue for BCFC. However, when the institutions of higher education encroach on private business activities, there are a number of undesirable consequences.

Entities organized under various provisions in section 501(c) of the Internal Revenue Code are provided special tax "exempt" treatment were clearly intended to perform activities and provide services otherwise considered "governmental" in nature, not those that are commercially available. A 1954 report by this Committee noted:

"The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds and by the benefits resulting from promotion of the general welfare."

Source: *(Unfair Competition: The Profits of Non-profits, James T. Bennett, Thomas H. DiLorenzo, Hamilton Press, 1989, p. 26)*

The problem is, this policy has not been adequately codified by Congress or efficiently implemented by the IRS. The situation has become so pervasive that unfair government-sponsored competition has been a top issue at every White House Conference on Small Business.

In 1980, the first White House Conference on Small Business made unfair competition one of its highest-ranked issues. It said, "The Federal Government shall be required by statute to contract out to small business those supplies and services that the private sector can provide. The government should not compete with the private sector by accomplishing these efforts with its own or non-profit personnel and facilities."

In 1986, the second White House Conference made this one of its top three issues. It said, "Government at all levels has failed to protect small business from damaging levels of unfair competition. At the federal, state and local levels, therefore, laws, regulations and policies should ... prohibit direct, government created competition in which government organizations perform commercial services ... New laws at all levels, particularly at the federal level, should require strict government reliance on the private sector for performance

of commercial-type functions. When cost comparisons are necessary to accomplish conversion to private sector performance, laws must include provisions for fair and equal cost comparisons. Funds controlled by a government entity must not be used to establish or conduct a commercial activity on U.S. property."

And the 1995 White House Conference again made this a priority issue when its plank read, "Congress should enact legislation that would prohibit government agencies and tax-exempt and anti-trust exempt organizations from engaging in commercial activities in direct competition with small businesses." That was among the top 15 vote getters at the 1995 Conference and was number one among all the procurement-related issues in the final balloting.

Non-profit organizations, including universities, unfairly compete with private, for-profit businesses by engaging in commercial activities, but not paying taxes.

Billions of dollars in economic activity occurs each year that is untaxed. This results in lost revenue to Federal, as well as state and local government agencies. And it creates an unlevel playing field for the private sector, particularly small business. When this occurs in universities, it unnecessarily drives up the cost of room, board, tuition and fees.

The 2013 IRS Colleges and Universities Compliance Project studied the unrelated business income tax (UBIT) for which tax-exempt entities, such as most universities, are required to pay on any activities and revenue unrelated to their tax-exempt status. The April 25, 2013 [IRS report](#) "found increases to unrelated business taxable income for 90 percent of the colleges and universities examined, totaling about \$90 million. There were over 180 changes to the amounts of unrelated business taxable income reported by colleges and universities on Form 990-T; and disallowance of more than \$170 million in losses and net operating losses that could amount to more than \$60 million in assessed taxes."

Non-profit organizations are provided special tax status under section 501(c) of the Internal Revenue Code. These groups are required to pay an "unrelated business income tax" or UBIT on its commercial or "non-exempt" activities. The IRS report showed this is not occurring.

The Federal Government first exempted charitable organizations from tax in 1913. In 1950, in response to outrageous examples of unfair competition, Congress changed the tax law by creating the UBIT. Under UBIT, revenues from sources unrelated to the non-profit's tax-exempt purpose are subject to taxation.

Attempts by government to address the problem of unfair competition have been few and far between, and those few measures that have been taken have been largely ineffective. The UBIT which was intended to level the playing field by taxing the revenues of non-profits has, for example, proven difficult if not impossible to enforce. The courts have not been able to give a rigorous and consistent definition of just what constitutes an "unrelated" business activity by a non-profit. And because the UBIT tax was to apply only to "commercial activity which is not significantly related to the purposes for which the non-profit organization was established," enforcement and collection by the IRS has been less than successful. For their part, non-profits, including universities, have taken an extremely expansive view of

what constitutes a related purpose, making the under-reporting or non-reporting of revenues commonplace.

Unfair university competition impedes the development of small business by making it hard for them to enter markets and compete. This is significant because two-thirds of all new jobs are created by businesses with fewer than 20 employees. Because commercial enterprises run by non-profits, including universities, are exempted from taxes and receive other subsidies, taxpaying businesses must bear an extra burden by paying higher taxes than they would otherwise to make up for exemptions enjoyed by their "non-profit" competitors. Unfair competition ends up crowding out of the market precisely those firms which are the principal source of new jobs—ultimately reducing the rate of economic growth.

Unfair university competition takes many forms. It is universities venturing out of the classroom and into activities unrelated to their core and exempt education mission, such as hotels, mapping services, bicycle repair, golf courses, gym and fitness centers, cultural resource assessments, testing laboratories and others. A few examples were highlighted in BCFC's 2013 and 2014 lists of the most egregious examples of unfair government competition as collected by media reports, include:

- The University of Mary Washington's Alumni Center in Fredericksburg, VA not only competed for similar events and opportunities as provided by a neighboring small business in the wedding, banquet, lodging and catering business, but it also was building a hotel less than a mile away that would further compete with the hotels, motels and other lodging destinations that are not tax-exempt. The only reason provided by lost clients for choosing the university was the lower price thanks to the tax differential. University hotels and conference centers are proliferating across the country;
- George Mason University in Fairfax, Virginia announced in December 2013 it would close its hotel, the Mason Inn, after losing \$11 million;
- Towson University, a Maryland state University in the Baltimore suburbs, purchased air time on Washington, DC radio stations advertising a nursery school program for children 2, 3, and 4 years of age and a summer camp programs for pre-teens;
- "Bluffing" to win its first contract, St. Mary's University (MN) performed commercially available mapping services for the National Park Service and other clients;
- The University of Houston operates the National Center for Airborne Laser Mapping (NCALM), mapping services utilizing aircraft equipped with Light Detection And Ranging (LIDAR), a technology commercialized by NASA in the 1990s. Towson also runs a mapping program that has purchased television ads touting a software system that is otherwise commercially available;
- Believing that bicycle repair is inherent to the success of higher education, Virginia Tech University opened its own shop and hired a mechanic to pedal services to students in Blacksburg, VA in competition with local small business;
- James Madison University in Harrisonburg, VA operates a variety of charter bus and transit options to not only university students, but also to the general public including local school systems thereby in direct competition and duplication of the local market as would be provided by the small business operators; and
- Elon University in North Carolina started Live Oak Communications, a communications agency that provides public relations, advertising, special event marketing, viral marketing, media relations, website development, video creation and

graphic design services for businesses and not-for-profit organizations in the North Carolina region.

The previously referenced 2013 IRS report listed the following activities as within its scope of UBIT research: Fitness, recreation centers and sports camps; advertising; facility rentals; arenas; and golf.

Another form of university competition is in the schools' bookstore. These on-campus, university-owned retail operations go far beyond selling essential textbooks to students, but compete with local, for-profit, tax-paying business in offering office supplies, clothes and apparel, computer equipment and goods under the blanket of the institution's tax exempt status. Finally, universities historically competed with travel and tour companies by offering foreign trips that looked more like vacations rather than instructional endeavors.

Schools of higher education are increasingly venturing away from their core missions of teaching and conducting basic research. Financial pressures, ranging from reduced government funding to pressures to limit tuition increases have led university presidents to transform academicians into entrepreneurs. Universities are generating revenues from commercial activities to supplement their budgets.

University engagement in commercial activities could be called the "Gatorade Syndrome". Ever since professors at the University of Florida invented the popular sports drink to hydrate football players practicing in the heat, academicians have been trying to find the next big discovery. Most simply consume tax dollars, divert scarce resources including tuition, and fail to turn profits. These university-sponsored enterprises have cost their schools millions, exacerbating an unaffordable tuition system that has made a college education a financial burden, if not impossibility, for most students and their parents.

Universities enjoy significant advantages over for-profit companies. They are eligible for billions of dollars in grants from Federal and State governments. They often have the ability to secure non-competitive, sole source contracts with government agencies. They pay no taxes. Their overhead – buildings, electricity, even equipment, is already paid for and is provided for "free". Their student labor force is either unpaid or compensated at well below prevailing market wages. They carry no professional liability insurance, do not have to pay unemployment compensation and in many cases are exempt from social security contributions. When universities enter into contracts to perform services, they usually insist on "best effort" clauses, which absolve them of ever completely finishing a project. They are also recipients of millions of dollars in free or discounted hardware and software, donated from vendor firms so that students will learn on their systems, be proficient in their use upon graduation and instill a consumer loyalty that will translate into sales once these students move up in the ranks of their private sector employers. The advantages universities bring to the market make it virtually impossible for private firms to compete.

Private sector and for-profit colleges and universities face unfair competition from government institutions. In recent years, such private schools have been singled out for attack from a bevy of regulations proposed by the federal government that create an unfair and unlevel playing field. The latest effort comes in the form of a retooled "gainful employment" regulation by the Department of Education that is impacting private sector schools and largely leaving traditional public and non-profit schools untouched. The "gainful

employment" regulation prevents students – often low-income, minorities, and veterans – from having access to thousands of programs at private sector higher education institutions.

In addition, federal actions, including the "90/10 rule", regulations dealing with state authorization, and the definition of a credit hour all threaten to punish private sector schools to the advantage of traditional public institutions.

For too many years, the unfair government-sponsored competition issue has not been a top priority for Congress or Administrations of either party. The Small Business Administration's Office conducted a series of hearings and issued a report, "Government Competition: A Threat to Small Business" (March 1980), and "Unfair Competition by Non-profit Organizations With Small Business: An Issue for the 1980s" (June, 1984). The last serious look at non-profits and the UBIT by the Ways and Means Committee was by Congressman J.J. Pickle (D-TX) in 1987-88.

In February 2013, BCFC testified before this Committee including "unfair university competition" and UBIT within the hearing entitled, "Tax Reform and Charitable Contributions."

From April 18 through April 25, 1993, the Philadelphia Inquirer presented an exhaustive investigative exposition of the multibillion-dollar world of America's so-called non-profit industries, exposing, in several different contexts, the abuses of their unique tax-exempt status. Certainly, this sweeping indictment by the Philadelphia Inquirer encompasses the world of non-profit sometimes run amok. However, as you, Mr. Chairman, contemplate future oversight hearings and legislation to reform this multibillion-dollar, non-tax-paying competition for many of America's struggling small businesses, you will find valuable factual, albeit dated, information in the Inquirer series.

Source: (Non-profits: America's Growth Industry They're Called Non-profit Businesses, But That Doesn't Mean They Can't Make Money. They Do - Billions Of Dollars. At The Same Time, Their Tax-exemptions Cost Government More Than \$36 Billion A Year," by Gilbert M. Gaul and Neill A. Borowski, The Philadelphia Inquirer April 18, 1993)

In February 1987, a GAO report found:

- The U.S. Department of Commerce estimates that \$1.2 billion, or 1.3 percent, of the \$91 billion gross national product (GNP) in 1930 could be attributed to non-profit institutions. This share grew to \$131 billion, or 3.3 percent, of the \$3,989 billion GNP by 1985;
- A 1975 IRS Statistics of Income (SOI) study found that for tax-exempt organizations (religious, schools and colleges, cultural and historical, other instructional, health-related services, scientific research, business and professional, farming and related, mutual organizations, employee or membership benefit, sports-athletic-recreational and social, youth, conservation and environmental, housing, inner city or community, civil rights, litigation and legal aid, legislative and political advocacy, other activities directed to individuals, other activities directed to organizations, other purposes and activities, no activity reported) on average, 39% of their total activity receipts were business receipts; and

- Complete data do not exist to quantify the nature, extent, and impact of competition between non-profits and the private sector. However, the limited data available indicate that taxable businesses and some tax-exempt organizations are increasingly competing to provide similar services.
Source: (GAO Briefing Report to the Joint Committee on Taxation; "Tax Policy: Competition Between Taxable Businesses and Tax-Exempt Organizations", February 27, 1987 – GGD-87-40BR)

In March 1980, a report of the Small Business Administration (SBA) Advocacy Task Force Group on Government Competition with Small Business found:

- The activities of foundations and universities were of particular concern to a number of witnesses;
- In Fiscal Year 1978, the IRS audited approximately 17,000 of the 150,000 required filings by non-profits. Unrelated business income was discovered in 1,800 or 10.6 percent of these 17,000 audited cases. Of the 1,800 audits where unrelated business income was discovered, 46 percent (828 cases) resulted in successful action by IRS to levy additional taxes, and a combined total of \$10 million was recovered. On average, the IRS recovered additional taxes at the rate of \$12,078 per audited case where unrelated business income was discovered and recovery action succeeded; and
- The small business community's perception of the extent of abuse of the tax system by non-profits strongly suggests that a more extensive review of unrelated business income activities is warranted.
Source: ("Government Competition: A Threat to Small Business" Report of the SBA Advocacy Task Force Group on Government Competition with Small Business, March 1980)

This is a problem that is growing, not diminishing. From 1975 to 1990, the non-profit sector grew by 150 percent, while the gross domestic product grew about 50 percent.

University competition is part of a larger problem of unfair government sponsored and tax-subsidized competition with private enterprise including government (including the insourcing of contracts performed by tax-paying private sector firms out of the private sector for performance by Federal employees), non-profits, prison industries, etc. The Federal government and universities can lower costs and increase revenue by applying the "Yellow Pages' Test", a simple test that says if an activity is available from a private sector company found in the Yellow Pages, that activity should not be a responsibility of a college and university and, instead, should actually be performed by a tax-paying private sector firm.

In December 2012, BCFC attempted to bridge the impasse in negotiations on the fiscal cliff and sequestration by providing President Obama and Congressional leaders budget savings of \$795 billion by simply utilizing tax-paying private sector firms for commercially available goods and services currently performed by a government or tax-subsidized entity. The federal government can achieve \$795 billion in savings simply by getting out of activities that duplicate or compete with the private sector, which subsidize unfair competition with private, for-profit companies, or by privatizing activities for which there are current or potential private sector providers. This includes:

- Enforce UBIT on commercial activities revenue of non-profits - \$36 Billion.

Institutions of higher education should not be able to use their tax-exempt status to avoid paying income taxes on what are essentially commercial activities. These tax-subsidized entities should not be making the same kind of profits on activities that are virtually identical to those of a for-profit, tax-paying business.

The IRS should more vigorously enforce current rules governing the tax status of universities to assure that academic activities are indeed related to research and education, not commercial production. Here are five very specific recommendations.

1. The Department of the Treasury should be required to provide an annual public estimate of revenues lost through avoidance of UBIT.
2. The Treasury Department should provide an official public estimate of potential new revenues to the Treasury if the UBIT law were expanded to require all commercial operations of universities to pay their fair share of taxes.
3. The law should be modified or new legislation introduced that lets the Treasury Department collect taxes that insures that all commercial activities of universities are taxable. The IRS has only one option today – that is to revoke an organization's charter to do business. They simply can't administer the law the way it is.
4. Congress should amend the Higher Education Act to focus universities on their core missions – education and basic research. Legislation should be passed to apply a "commerciality" test to all non-core university activities. Any university that receives direct federal funding, or indirect funding through tax-exempt or "non-profit" status, should be prohibited for using such institutions for the performance of commercial, tax generating activities otherwise available in the private sector.
5. Universities entering a commercial undertaking should be required to form a for-profit subsidiary that must obey all the same laws and regulations that apply to for-profit enterprises. It is only when we move beyond hidden subsidies and the ineffectual regulations of UBIT that both consumers and producers, and all taxpayers, will be able to enjoy the benefits of even-handed competition. In forming a commercial subsidiary, this would help implement a "commerciality clause", and thus implement the "'Yellow Pages' Test".

Unfair university competition with the private sector, and small business, is a public policy issue deserving of immediate attention and reform. This hearing will provide an important forum for the private sector to discuss the broader aspects of this issue. We commend your efforts to further explore private sector complaints in this area and advance the debate. The private sector seeks a competitive environment in which all participants play by the same rules.

Business Coalition for Fair Competition (BCFC)
1856 Old Reston Avenue, Suite 205, Reston, VA 20190, (703) 787-6665
www.governmentcompetition.org

NEXUS Research & Policy Center

April 2015

Rich Schools, Poor Students: Tapping Large University Endowments to Improve Student Outcomes

Dr. Jorge Klor de Alva

President, Nexus Research and Policy Center
3701 Sacramento St. 297
San Francisco, CA 94118
602.684.5401
jorge@nexusresearch.org

Dr. Mark Schneider

Senior Research Fellow, Nexus Research and Policy Center
President, College Measures
Vice President, American Institutes for Research
1000 Thomas Jefferson Street, NW
Washington, D.C. 20007
Phone: (202) 403-5000
mschneider@air.org

In this report, available at www.nexusresearch.org, we show that:

- Not all private universities are private. Many of the richest universities in the country, sitting on hundreds of millions if not billions of dollars in tax exempt endowments, receive government subsidies through tax laws that dwarf the appropriations received by public universities and colleges.
 - For example, Princeton's tax exempt status generates over \$100,000 per student each year in taxpayer subsidies, compared to the \$12,000 per student taxpayer subsidy at Rutgers University, the state flagship, \$4,700 per student at the

regional Montclair State University, and at the nearby community college, Essex County College, \$2,400 per student (see Table 1 below).

- Because these rich schools receive large tax-generated subsidies but enroll a disproportionately small share of low-income students, a perverse pattern results wherein the richer the school, the lower the percentage of needy students served (see Figure 1 below).
 - This “welfare for the wealthy” results from a tax code that hides the flow of money to the rich while public schools have to fight for appropriations in state legislatures, where they must compete against other legitimate public policy needs.
- Providing free community college tuition by taxing rich *individuals* is neither politically feasible nor the best use of limited resources. On its own, such a program would result primarily in driving more students into schools that are already having difficulty leading students to successful academic and workplace results. Instead, a more politically viable approach would be to impose a low excise tax on private universities with endowments of over \$500 million (see Table 2 below) and investing the revenue in evidence-based student support services proven to get more students successfully through community colleges.

This tax is modest and similar to the tax rate that private foundations are already subject to.

- In 2014 the 95 private colleges with such endowments educated less than 5 percent of total higher education students.
- Given the extremely unequal distribution of endowments, over 84 percent of the over \$5 billion in revenues would come from only 20 colleges, which last year educated fewer than 2 percent of the nation’s college students.
- To help minimize the impact of the proposed tax, we recommend that the proposed tax be offset annually by the amount the school appropriates for financial aid to low-income Pell eligible students.
- The revenue raised from the excise tax would be for the benefit of students attending community colleges—institutions that are seriously under resourced yet responsible for training much of the nation’s workforce. We believe that this can be done in a revenue neutral manner that incentivizes corporations to strengthen their support of local community colleges. To do so, we propose that a new charitable tax credit be established that builds on the tax legislation that created several types of tax credit bonds under the Internal Revenue Code.
 - The proposed taxing arrangement is revenue neutral because the revenue from the excise tax would match the amount offset by the tax credit gained by

participating individuals or corporations. In effect, if a taxpayer gave, say, \$1 million to a community college they could get an extra percent of credit against taxes owed. The total amount of extra tax credit allowed by the program would offset the amount of revenue raised by the excise tax on the large endowments.

- In turn, the value of the tax credits would match the annual flow of money to be made available to community colleges for qualified purposes. A competitive grant process would be used to assure that selected community colleges applied the funds to support practices proven to be effective in promoting student success.
- As was the case with the previous qualified tax credit bonds, administered by the Treasury Department and used to support a variety of educational and energy initiatives, these charitable tax credits can provide an attractive opportunity for corporations or others seeking to reduce their tax burden in a socially responsible manner.
- Similar to the way Treasury issued the tax credit bonds to support specific activities that met criteria set by rules, regulations or legislation, the tax credit would not be available to all. A panel of experts would be established with responsibility for judging the applications and making awards based on the conformance of the application to the established criteria.
- The proposed tax credits can build on these past procedures to support the implementation of practices that are proven to benefit community college students.
 - First, Treasury would estimate the annual yield of the excise tax on endowments over \$500 million.
 - Second, Treasury would fix the amount to be offset through the tax credits to equal that yield.
 - Third, the U.S. Department of Education (USDOE) would establish a panel of experts to determine the qualifying criteria and evaluate the proposals from community colleges.
 - Fourth, USDOE would publicize a request for proposals from community colleges. The call would specify that only activities with evidence that they are associated with student success—measured by indicators such as increased student progression, retention, completion, or job placement—would qualify for financial support.
 - Fifth, interested community colleges would help identify taxpayers interested in the tax credits. This effort would help promote links between colleges and corporations that are critical to resolving the current gaps between what is taught and the workplace skills and competencies needed by industries.
 - Periodic evaluation of the effectiveness of the program would assure that it would be continually improved for continuous success.

In summary, access without success is not opportunity. And welfare to the wealthy through hidden subsidies is not good policy. This study shines light on the latter and

proposes a revenue neutral way to apply money generated by reforming existing tax policy to provide real opportunities for success to community college students.

Table 1: Total Federal, State and Local Appropriations and Tax Subsidies* Per FTE Student, Endowment Size, and Institution Type**

State	Private - High Endowment	Private - Midlevel Endowment	Private - Low Endowment	Public Flagship	Public Regional	Community College
CA	Stanford University	Biola University	Holy Names University	U. of Calif., Berkeley	Cal State U.-Fullerton	Fullerton College
	\$63,100	\$1,300	\$700	\$10,500	\$4,000	\$8,100
CT	Yale University	Connecticut College	U. of St. Joseph	University of Connecticut	Central CT State U.	Tunxis Community C.
	\$69,000	\$5,700	\$900	\$23,300	\$6,700	\$6,200
IL	University of Chicago	North Central College	Olivet Nazarene University	U. of IL, Urbana-Champaign	Western Illinois University	Waubensee Community C.
	\$19,300	\$1,200	\$300	\$7,500	\$12,600	\$8,000
IN	Notre Dame University	Indiana Wesleyan University	St. Mary-of-the-Woods College	Indiana U., Bloomington	Indiana State U. Terre Haute	Ivy Tech Community C.
	\$26,900	\$600	\$400	\$7,000	\$7,200	\$3,100
MA	Harvard University	Bentley University	Laboure College	U. MA, Amherst	Bridgewater State U.	Massasoit Community C.
	\$48,000	\$2,200	\$200	\$9,900	\$4,600	\$4,100
NC	Duke University	Guilford College	High Point University	UNC, Chapel Hill	UNC, Charlotte	Central Piedmont C.C.
	\$13,400	\$1,000	\$400	\$24,400	\$8,800	\$5,100
NJ	Princeton University	Rider University	Centenary College	Rutgers University	Montclair State U.	Essex County College
	\$105,000	\$500	\$900	\$12,300	\$4,700	\$2,400
NY	Columbia University	Alfred University	Keuka College	Stony Brook University	CUNY, Queens	Queensborough Community C.
	\$14,500	\$2,000	\$300	\$16,800	\$5,300	\$5,300
PA	University of Pennsylvania	Robert Morris U.	Keystone College	Pennsylvania State U.	IN U. of Pennsylvania	Westmoreland Co. C. C.
	\$27,000	\$300	\$100	\$9,000	\$8,400	\$2,700
TX	Rice University	U. of the Incarnate Word	Texas College	University of Texas, Austin	Texas State U., San Marcos	Austin C.C., San Marcos
	\$24,500	\$400	\$100	\$32,500	\$4,400	\$6,400
AVERAGE	\$41,100	\$1,500	\$400	\$15,300	\$6,700	\$5,100

* Does not include subsidies based on property tax exemptions.

**Based on 2013 endowments: high endowments (HE) average \$1,570 million, medium endowments (ME) \$15 million, low endowments (LE) \$2 million.

Figure 1: Median Percent Federal Pell Grant Participation versus Average Taxpayer Subsidy by Institutional Type, 2013

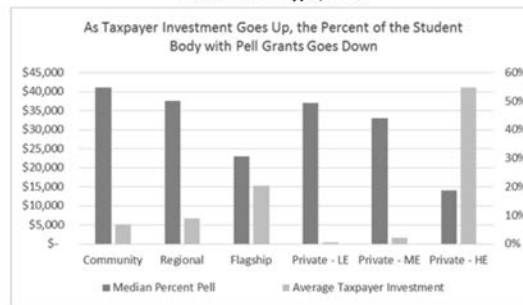


Table 2: Proposed Annual Excise Tax Rates, Number of Colleges Affected and Expected Tax Revenue Based on 2014 Endowment Size

Size of Endowment	Number of Private Colleges Affected	Tax Rate	Total Endowment	Expected Tax Revenue
>\$3 Billion	20	2.0%	\$210,621,635,000	\$4,212,433,000
>\$2+ Billion	8	1.5%	\$18,057,573,000	\$270,864,000
>\$1 Billion	28	1.0%	\$39,003,557,000	\$390,036,000
>\$0.5 Billion	39	0.5%	\$27,816,551,000	\$139,083,000
TOTAL	95	~1.36%	\$295,499,316,000	\$5,012,416,000

Source: 2014 NACUBO-Commonfund Study of Endowments¹¹

¹¹ NACUBO. (2015). *U.S. and Canadian institutions listed by fiscal year (fy) 2014 endowment market value and change in endowment market value from fy2013 to fy2014*. Retrieved from http://www.nacubo.org/Documents/EndowmentFiles/2014_Endowment_Market_Values_Revised.pdf.

Selected media discussing/referencing the content of the report *Rich Schools, Poor Students*:

1. 04/06/15 "Are Harvard, Yale, and Stanford really public universities?" <http://www.washingtonpost.com/news/grade-point/wp/2015/04/06/are-harvard-yale-and-stanford-really-public-universities/?postshare=6461428331337734>
2. 04/06/15 "Tax-Exempt Status of Large College Endowments Hurts Taxpayers, Report Argues" http://chronicle.com/blogs/ticker/tax-exempt-status-of-large-college-endowments-hurts-taxpayers-report-argues/96775?cid=pm&utm_source=pm&utm_medium=en
3. 04/06/15 NAICU reporting on Nexus study <http://www.naicu.edu/search/?q=Klor+de+Alva&x=9&y=7>
4. 04/07/15 "Report: Institutions With The Fewest Low-Income Students Get The Most Taxpayer Support" <http://www.highereducationforall.com/fewest-low-income-most-taxpayer-support/#.VSRvzIr3anN>
5. 04/09/15 "ARE HARVARD, YALE, AND STANFORD REALLY PUBLIC UNIVERSITIES?" See *Thru EDU*, Center for Higher Education, Texas Public Policy Foundation <http://seethruedu.com/are-harvard-yale-and-stanford-really-public-universities/>
6. 04/14/15 "'Belling the Cat' of Investments in Higher Education" http://rethinkinghighered.blogspot.com/2015_04_01_archive.html
7. 04/14/15 "Study examines U.'s tax-exempt status, proposes excise tax on U. endowment" <http://dailyprincetonian.com/news/2015/04/study-examines-u-s-tax-exempt-status-proposes-excise-tax-on-u-endowment/>
8. 04/22/15 "It's time to target rich tax breaks for private colleges" <http://www.sacbee.com/opinion/op-ed/soapbox/article19247469.html>
9. 04/22/15 "Study Proposes Excise Tax on Harvard's Endowment" <http://www.thecrimson.com/article/2015/4/22/study-harvard-excise-tax/>
10. 04/24/15 "The rich get richer in higher ed: 40 colleges hold two-thirds of the wealth, and growing" <http://www.washingtonpost.com/news/grade-point/wp/2015/04/24/the-rich-get-richer-in-higher-ed-40-colleges-hold-two-thirds-of-the-wealth-and-growing/>
11. 05/05/15 "A tax whose time has come" <http://www.ccdaily.com/Pages/Funding/A-tax-whose-time-has-come.aspx>
12. 05/15/15 "Rich Schools, Poor Students" A "Must Read" in CEO to CEO American Association of Community Colleges, Issue #038
13. 05/15/15 "Malcolm Gladwell at the 95th Annual AACC Convention" speaks about Nexus report. A "Must Watch" in *CEO to CEO American Association of Community Colleges*, Issue #038
14. 05/21/15 "Widening Wealth Gap" <https://www.insidehighered.com/news/2015/05/21/rich-universities-get-richer-are-poor-students-being-left-behind>
15. 05/22/15 "Financial gap growing in American higher ed" <http://www.educationdive.com/news/financial-gap-growing-in-american-higher-ed/399675/>

16. 05/27/15 "Tax Harvard! President Barack Obama wants to make college more affordable. Here's a way to do it" <http://www.politico.com/agenda/story/2015/05/obama-tax-harvard-affordable-college-000028>
17. 05/28/15 "Addressing the Inequity Gap" <https://www.insidehighered.com/news/2015/05/28/report-calls-extending-k-12-funding-model-high-need-community-colleges#.VWb1afx-xiE.mailto>
18. 05/28/15 "How Higher Education Funding Shortchanges Community Colleges" <http://www.tcf.org/blog/detail/how-higher-education-funding-shortchanges-community-colleges>
19. 06/04/15 "Do community colleges deserve better funding?" <http://www.cbsnews.com/news/do-community-colleges-deserve-better-funding/#postComments>
20. 06/08/15 Ed Rogers, speaking about Hillary's quandary of past acts versus what the Democratic base wants, asked "Will she work with Sen. Charles Grassley (R-Iowa) on reforming tax-free organizations?" <http://www.washingtonpost.com/blogs/post-partisan/wp/2015/06/08/the-insiders-how-will-clinton-reconcile-her-past-with-her-platform/>
21. 06/08/15 An article referencing our study while asking "Elite Colleges Have Public Funds For Low-Income Students, So Why Aren't They Enrolling More Of Them?" <http://genprogress.org/voices/2015/06/08/37013/elite-colleges-have-public-funds-for-low-income-students-so-why-arent-they-enrolling-more-of-them/>
22. 06/08/15 "Elite Colleges Have Public Funds For Low-Income Students, So Why Aren't They Enrolling More Of Them?" <http://genprogress.org/voices/2015/06/08/37013/elite-colleges-have-public-funds-for-low-income-students-so-why-arent-they-enrolling-more-of-them/>
23. 06/09/15 The National Journal's event on The Next America: Taking Stock 50 Years of the Higher Education Act, the moderator, Ronald Brownstein (Atlantic Media's Editorial Director for Strategic Partnerships, in charge of long-term editorial strategy), referencing the Nexus study, asked Ted Mitchell to respond to it (see <https://www.youtube.com/watch?t=336&v=0ovSJREgrLA> beginning at 1:02:18).
24. 08/20/15 Malcolm Gladwell Tweet: A fascinating look at how taxpayer subsidies for higher Ed vary by institution. http://nexusresearch.org/wp-content/uploads/2015/06/Rich_Schools_Poor_Students.pdf See <https://twitter.com/Gladwell/status/634434466484781056>.
25. 08/22/15 In Elite Schools' Vast Endowments, Malcolm Gladwell Sees 'Obscene' Inequity. <http://www.npr.org/2015/08/22/433735934/in-elite-schools-vast-war-chests-malcolm-gladwell-sees-obscene-inequity>
26. 08/25/15 Should College Endowments Be Taxed? <http://www.forbes.com/sites/beltway/2015/08/25/should-college-endowments-be-taxed/>
27. 09/07/15 Is It Time to Tax Harvard's Endowment? http://www.slate.com/articles/business/moneybox/2015/09/harvard_yale_stanford_endowments_is_it_time_to_tax_them.2.html
28. 09/08/15 Should nonprofit Harvard's \$36B endowment be taxed to pay for public colleges? http://www.nola.com/education/index.ssf/2015/09/taxing_harvards_endowment_univ.html

29. 09/08/15 Let's Consider Taxing Elite Colleges' Huge Endowments
<http://www.newser.com/story/212529/lets-consider-taxing-elite-colleges-huge-endowments.html>
30. 09/09/15 Malcolm Gladwell has a huge problem with a government handout given to America's Ivy League
<http://www.businessinsider.com/elite-private-colleges-dont-have-to-pay-taxes-on-their-endowments-2015-9>
31. 09/10/15 Yale, Harvard, and Princeton have billions in endowment money but still get a huge boost from the government
<http://www.businessinsider.com.au/elite-private-colleges-dont-have-to-pay-taxes-on-their-endowments-2015-9>
32. 09/14/15 Should Stanford's Endowment Be Taxed? NPR's "Forum with Michael Krasny"
<http://www.kqed.org/a/forum/R201509140930> Download audio (MP3)

